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ABSTRACT

This report documents the recent course of events in government spending, taxing, and employment at all three levels of government. It also speculates on the nature and causes of fiscal containment in its myriad forms. The report devotes one chapter to a case study of city budgets in Los Angeles during the five years of rapid growth immediately preceding the passage of Proposition 13. Finally, it investigates the history and current status of the fiscal limitation movement. The report concludes that (1) the current American tax revolt is merely the latest in a historical series, (2) Proposition 13 represents only one form of fiscal limitation, (3) evidence exists that current fiscal limitation measures, though generally slowing the rate of government growth, have not had as great an effect as their supporters had hoped, and (4) fiscal limitation statutes and constitutional amendments are but one of many causes of the restrained growth of state and local government that has occurred over the last five years. (Author)

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FISCAL CONTAINMENT OF LOCAL AND STATE GOVERNMENT

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PREFACE

The research reported here was sponsored by The Ford Foundation, with additional support from Rand corporate funds. Four other Rand publications are of related interest:

- *Fiscal Containment: Who Gains? Who Loses?* R-2494/1-FF/RC, September 1979, summarizes the present report's major findings.
- *Growth in Municipal Expenditures: A Case Study of Los Angeles*, by Jan M. Chaiken and Warren E. Walker, N-1200-RC, June 1979. This Rand-sponsored note examines spending patterns in the City of Los Angeles prior to the passage of Proposition 13. Its findings are summarized in this report and in R-2494/1-FF/RC.
- *The Fiscal Limitation Movement: Present Context and Outlook*, by Phyllis Ellickson, N-1160-FF, May 1979. Sponsored by The Ford Foundation, this note describes current approaches to subnational fiscal limitation, compares them with previous ones, and discusses likely effects of the fiscal limitation movement. Its findings are also summarized in this report and in R-2494/1-FF/RC.
- *Political and Legal Responses to Proposition 13 in California*, by Albert J. Lipson and Marvin M. Lavin, R-2483-DOJ (forthcoming), is sponsored by the National Institute of Law Enforcement and Criminal Justice and by Rand. The report traces the development of state legislation that implemented Proposition 13 and cushioned its first-year impact on local government.

Our research would not have been possible without the support and encouragement of James Kelly, of The Ford Foundation, and David Lyon, of Rand. We also gratefully acknowledge the assistance of Rand colleagues Sue Berryman, Brent Bradley, Richard Buddin, Millicent Cox, Nicelma King, Albert Lipson, Lorraine McDonnell, and Wayne Perry. Stephen Carroll, of Rand, and John Kirlin, of the University of Southern California's

School of Public Administration, offered valuable comments and suggestions on an earlier draft. Michael Caggiano and Joanne Wuchitech especially contributed to this report's preparation.

SUMMARY

The "tax revolt," the enactment of state-level fiscal limits, and deterioration in the local tax base, together promise to contain future growth in subnational government in the United States. Attitudes of the public and its elected representatives have fueled this movement and will speed the process of containment. Since 1975, the fraction of GNP accounted for by government spending has fallen for the first time in fifty years; other indicators suggest that the government fraction is fast approaching its peak and may well turn downward.

This report documents, in synoptic form, the recent course of events in government spending, taxing, and employment at all three levels of government. It also briefly reviews the fiscal limitation movement and its accomplishments. The report includes the findings from a case study of the recent fiscal history of Los Angeles, which may help explain taxpayer discontent.

Prevailing sentiment, as expressed through the American political system, appears to favor containment, if not contraction, in government. Along the road to this objective, some groups are likely to suffer as others gain. The report concludes with an assessment of the likely social costs and political effects of containment. It is offered in the hope that, armed with foreknowledge, the nation can avoid causing needless harm through unreflected zeal.

TRENDS IN LOCAL AND STATE FINANCE

A period of fiscal containment is upon us. There is accumulating evidence that the growth period in local government is coming to an end, or at least peaking. Rates of growth in spending and employment have substantially abated over the past few years as compared with the rates registered in the postwar era up to 1975. Over this time the property tax has declined in importance as a source of local revenues while grants from state and federal government have taken on greater importance. For a number of reasons, however, intergovernmental transfers may soon begin to diminish, too.

Fiscal activity by state government continues to grow, but growth has moderated at this level of government as well. For both state and local government, expenditures over time have shifted from those that benefit the citizenry at large--e.g., highways, elementary and secondary education, the protective services--to those that benefit more narrowly constituted subpopulations--public assistance, clinics and public hospitals, higher education, services for the elderly.

Fiscal containment has numerous causes. In many big cities the tax base shrinks as households and firms leave for the suburbs and the more remote regions of the country. Inflation erodes the value of grants from the federal government; it also raises the costs of everything that governments buy, so that constant-dollar levels of input purchases mean declining real levels of service outputs.* Voters in state and local elections seem increasingly disinclined to approve spending proposals they are offered on ballots and may have begun to favor the more frugal candidates in elections. Particularly during the 1970s, voters and their elected representatives are being asked to decide not merely on this bond override or that spending proposal but on, in effect, the overall fiscal dimensions of their jurisdictions.

THE FISCAL LIMITATION MOVEMENT

The most publicized cause of fiscal containment is what we have called the fiscal limitation movement, which has led to statutes and constitutional amendments designed to limit governments' ability to tax or spend. Fiscal limitation assumes a variety of forms. Sometimes, as in California's Proposition 13, collections from a particular form of tax are cut back. In that case it was the local property tax. (Property tax *rate* limits have a venerable history in American state government; controls over the total take of the property tax are newer.) Other variants seek to limit state income tax collections by "indexing" them against inflation. Commoner still are "cap laws," which restrict

*However, inflation also expands the base of revenue systems that are highly income-elastic, such as income taxes and property taxes in regions where real estate values have been rising disproportionately.

the future growth of state or local or combined state and local spending to some fraction of aggregate personal income, or to the rate of inflation, or to the expansion of population. Growth controls appear to generate fewer adjustment problems for subnational government than do tax cutbacks.

Twenty-three states passed some form of fiscal limitation, by statute or by constitutional amendment, during the 1970s; 16 of them have adopted some form of control since 1975 alone. What sort of state adopts fiscal limits? In the past, those with high tax burdens (i.e., as a proportion of income) and those with rapidly growing levels of per capita public expenditures appeared to be prime candidates. In the last few years the importance of such preconditions seems to have diminished. Fiscal limitation looks more and more like an epidemic in which susceptibility to infection has less to do with tax levels and population characteristics than with the dynamics of the current public mood: disenchantment with government.* The movement has struck in urban states and rural, in states where the constitution permits voter-initiated amendments and those where it does not, in states with historically low tax levels as well as those where burdens have traditionally been heavy.

ROOTS OF TAXPAYER DISCONTENT

As part of the research conducted to produce this report, we performed a case study of fiscal trends in the City of Los Angeles for the period 1973-1978. We were interested in exploring the roots of the voter dissatisfaction which led to the passage of Proposition 13. Los Angeles shares characteristics with other big cities in California and, on the spending side at least, its recent history parallels that of many municipalities in other parts of the nation. Property taxes in the city had increased by 50 percent over the five years and total municipal revenues at an annual rate of 11 percent. In the meantime,

*In California, the site of the most drastic of the recently adopted fiscal controls, skyrocketing property tax levies and the existence of a massive state surplus obviously also had much to do with the Proposition 13 landslide.

total employment remained about constant and the number of front-line providers of services to the public--police officers, firefighters, and sanitation workers--actually fell.

Where did the money go? Inflation of course meant higher costs in employee compensation and the other inputs cities buy. Los Angeles's expenses in these categories were not out of line with those experienced in other cities. Inflation was responsible for perhaps 74 percent of the spending increases between 1973 and 1978. But 11 percent of the increase was due to what we call "upward grade float"--the rise in the number of administrative and support personnel relative to front-line workers. There are now more such employees and they are better paid than the officer on the beat and the firefighter in the station house. In addition, there was absolute and relative growth in overhead and planning functions, such as the staffs of the mayor and city council, the City Attorney, and the Comptroller. Los Angeles voters did not have such information when they cast their ballots on June 6, 1978, but it would not be surprising if they felt that, over time, they were paying more and enjoying it less. Similar, if less extreme, reactions may well have been characteristic of citizens elsewhere.

FEDERAL RESPONSES TO FISCAL CONTAINMENT

The federal government has not as yet formulated an explicit policy for dealing with grant recipients who have enacted fiscal limitations. Many of the aid programs entail requirements for local matching funds and maintenance of effort, and for mandated program standards, which the shrinking of tax bases or the control of spending levels would seem to threaten. So far, however, there seem to have been few, if any, cases of the government's withholding federal funds because a state or local government could not or would not meet requirements. For the time being, federal regulations appear to be flexible enough in the standards they impose to permit continuation of accustomed grant flows. Whether fiscal controls will emerge at the federal level itself remains an open question. Advocates of various forms of control are becoming increasingly vocal. Their proposals range from tax cuts through mandatory budget balancing to constitutional amendments which tie future

expenditure increases to the rate of inflation. Should federal limitations come to pass, grant flows to states and local governments will be menaced.

THE SOCIAL AND POLITICAL CONSEQUENCES OF FISCAL CONTAINMENT

Fiscal containment appears to be the wave of the future, but may bring some adverse social and political side-effects with it. Some of these have serious implications for equity. Although California's enormous state surplus has cushioned the effects of Proposition 13, and although other states' controls are too new or too moderate to have immediate impacts, real pressures are bound to eventuate over the years. Four potential kinds of change need analysis.

Taxes and Charges

The first concerns shifts in the incidence of state and local revenue systems. Fiscal limits that force cutbacks in a single type of tax promise to shift resulting burdens. In California, homeowners and businesses have so far benefited relative to renters. Should user charges and the substitution of private for public services emerge as property-tax substitutes, high-income households will gain at the expense of those with lower incomes.* User charges have already been widely adopted in California for libraries, recreation facilities, development permits, and museum admissions. Studies of changes brought about in the distribution of burdens categorized by the income, location, and tenure of households seem worth undertaking.

Services

Reductions in service levels also appear likely over the longer term. If officials heed the preferences that citizens express in public opinion polls, programs that benefit relatively small groups--adult education, cultural services, welfare, health care for the indigent--

*But the loss of property tax deductions of state and federal income taxes and the fact that user fees are not deductible would moderate the overall regressiveness of the change.

will be the first targets for contraction. Newer services will also probably suffer because they represent ostensibly less valuable activities and because their clients are not as well organized politically as the longer established clienteles. "Fat-cutting" is easy to demand but hard to carry out systematically. Again, equity-oriented research can help provide answers. Particularly useful would be studies of jurisdictions that have successfully weathered fiscal containment. They would enable us to know what worked and who got hurt.

Public Employment

Cuts in government outputs imply reductions in public payrolls. Most politicians regard layoffs as a last resort, partly because public employees are active politically; there is much more appeal in hiring-freezes and reductions in real or "indexed" compensation. A common public opinion holds that many government employees are redundant and that many are overpaid. In California, terminations have been negligible but attrition reduced total public employment by 104,000 jobs, or 6 percent, in the year after Proposition 13's passage. State and local wages in California have lagged behind inflation. Freeze strategies can effectively reduce public payrolls, but when applied across the board they are arbitrary, in the sense that they primarily prune those governmental functions that have employees close to retirement or people who will have little trouble switching to jobs in the private sector--often the young and the mobile. Older, less mobile people, who have made a career of civil service may be hurt the most by reductions in real compensation.

Employment cutbacks in the public sector will affect minorities disproportionately. Because they rarely enjoy seniority, civil service regulations and union agreements will force them to bear the brunt of any layoffs. Many city governments employ a surprisingly large fraction of minority professionals and skilled workers--often double the fraction in the general labor force. The availability of higher-status jobs for blacks and Hispanics had been growing more rapidly in the public sector than in the private. Hiring freezes threaten to dislodge this stepping stone into the middle class for minorities. A leaner and smaller public sector may also turn out to be meaner and harsher.

Fiscal Containment and Local Control

Although fiscal containment appeals to conservatives, one of its side-effects may displease them. As local sources of revenues dwindle, pressure will mount for larger grants from higher-level government, notably the states. Affected client and employee groups will apply a great deal of that pressure. In the long term, control tends to follow hard on the heels of finance. As states and the federal government bail out needy localities, home rule--the responsiveness to local concerns--may be the ultimate victim.

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Chapter 1
INTRODUCTION

The movement to contain the fiscal powers of state and local governments was spurred by California's passage of Proposition 13 in June 1978. A nationally publicized voter initiative that amended the state constitution, Prop. 13 was supported by two-thirds of the voters. In its first year, it sharply cut back local property tax collections, reducing them by about $6 billion, 57 percent of the previous year's collections (*Proposition 13 Impact Reporter*, 1979, pp. 8-9). Other states passed tax limitation measures in November 1978, while the Kemp-Roth bill in the U.S. Congress and the movement for a federal constitutional amendment to balance the budget or control expenditures suggest that the antitax and antispending mood has reached the federal government.

Well publicized for the extraordinary event it was, Prop. 13 should nonetheless be viewed in its historical context. American tax revolts date back to Shays' Rebellion in 1786-87, and even before to the Boston Tea Party in 1773. Many states imposed constitutional limits on property tax rates about the turn of this century, and fiscal containment may be achieved without direct legislation if the mood of the voters discourages spending. (In fact, a poll taken before the November 1978 election--four months after Prop. 13 passed--showed that Congressional candidates were even more likely to express antitax attitudes than the voters) (*New York Times*, November 9, 1978, p. A21). Finally, fiscal containment can come about through the erosion of tax bases, as when firms and households migrate out of, or decline to settle in, certain jurisdictions--a phenomenon particularly evident in the larger cities of the Northeast and Middle West. By containment, then, we mean any of several instrumentalities by which fiscal activity may be constrained. Formal fiscal controls constitute one instrumentality. And whether the desire for containment results in actual contraction depends on the particular circumstances, as this report goes on to demonstrate.

SCOPE AND ORGANIZATION OF THE REPORT

We had a number of objectives in mind when we undertook this research.

First, we were interested in exploring the recent financial history of local and state government. We wondered whether their history would reveal a substantial upward trend in the burdens of taxation and the activity of subnational government that might portend a counter-reaction. And we wanted to know whether any evidence of the counter-reaction had yet appeared in the aggregate data.

Second, we wanted to see if changing public attitudes toward government might underlie the process of containment. We wanted information on both the tax burdens and service benefits that local taxpayers had experienced in recent years.

Third, we were interested in state statutes and constitutional amendments designed to control fiscal activity that were enacted in response to trends in taxation, spending, and voter attitudes. Proposition 13 is a dramatic example of a tax cutback measure, but we wanted to know how extensive other such controls are and whether they differ from what some have characterized as the "meat-ax" approach of Prop. 13. Aside from legislation, we also thought it important to examine the contribution to fiscal containment that is inherent in tax base erosion, declines in the real value of intergovernmental grants, and the election of more parsimonious officials.

Although our chief interest lay in the preconditions of containment, we were also concerned about a series of possible responses to fiscal containment, because we believed that some of the responses might portend important changes in political relationships and the relative positions of various subpopulations. The range of potential changes we attempted to analyze includes responses by the federal government to state level controls, shifts in tax burdens, reconstitution of government service packages, alterations in public employment opportunities, and loss of local control over the direction of government. Many of these possible ramifications pose important problems for social equity and political harmony.

Chapter 2 reviews trends in state and local finance and speculates on the nature and causes of fiscal containment in its myriad forms. Chapter 3 is a case study of city budgets in Los Angeles during the five years of rapid growth immediately preceding the passage of Prop. 13; it probes what taxpayers got in return for the 72-percent increase in city revenues during this period, and illuminates some of the possible causes for the passage of Prop. 13. Chapter 4 investigates the history and current status of the fiscal limitation movement. Chapter 5 suggests areas for future research, with a concentration on social and political effects. Chapter 6 presents our conclusions.

THE ROOTS OF FISCAL CONTAINMENT

American distrust of government, particularly powerful or centralized government, finds roots in the *Federalist* papers; voters' distrust of politicians (including the ones they voted for) is a parallel tradition. Public opinion polls quantify attitudes toward government and reveal changes in opinion.

In recent years, more and more citizens have come to distrust their government. A 1964 University of Michigan poll found that a minority, 22 percent of the population, believed that only some of the time--not most of the time--could the federal government be trusted "to do what is right." By 1976 that figure had risen to 62 percent--a strong majority (Citrin, 1978, pp. 6-11). Public confidence in other institutions also dropped in this period, but dissatisfaction with government is expressed at the polls; distrust of other institutions cannot be voiced so directly.

Most Americans think taxes are too high. Citrin (1978) provides a useful summary. The segment of the U.S. population believing that government wastes "a lot" of the money it collects in taxes grew from 56 percent in 1964 to 74 percent in 1976. Such negative attitudes are strongest toward the federal government, but apply to state and local government as well. By 1978, 66 percent of the public believed that taxes had reached "the breaking point" (up from 54 percent in 1969) and more than 70 percent felt they were not receiving their money's worth from the taxes they paid. In a poll conducted on the eve of the

Prop. 13 vote, 60 percent of Californians said they would accept a reduced level of services if it meant lower taxes. After Proposition 13's passage, a majority of survey respondents outside California expressed support for a similar form of property tax relief. In fact, the fraction of non-Californians supporting property tax relief was the same as the fraction of Californians who supported Prop. 13 (*New York Times*, June 28, 1978, pp. A1, A16). As Citrin (1978) noted, "All available evidence suggests that attitudes in the rest of the nation parallel those in California [with respect to the growing desire for limitations on government spending]." Citrin concludes by noting that as politicians recognize the public's growing conviction that government is wasteful and inefficient, they will be more inclined toward frugality in the conduct of public affairs.

Chapter 2 will demonstrate the accuracy of this perception. Taxes have indeed been rising as a share of national income. Their visibility is perhaps heightened by inflation and rather slow growth in real personal incomes, whereby taxes have accounted for an increasing share of an essentially fixed pie. When citizens are asked to detail their criticism of government, waste and inefficiency are most often mentioned. Thus, while three-quarters of the respondents to a *Washington Post* poll wanted taxes cut, two-thirds said they would forgo tax relief if governmental waste and inefficiency could be eliminated. Seven-eighths were less concerned with the level of taxation than with how governments spent the taxes (*Washington Post*, October 1, 1978, pp. A1, A16). When asked to specify "fat" in government, citizens often mention inessential, underused, of fraudulently consumed services (welfare and other social services generally top this list)[1] or the high salaries and fringe benefits they claim are wasted on allegedly lazy, dishonest, discourteous, and generally undeserving civil servants.[2]

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[1]See, for example, the *Washington Post*, October 1, 1978, and Ladd et al., 1979, p. 131ff. After the passage of Prop. 13, no more than 5 percent of Californians wanted police, fire, or garbage services "cut a lot," while 43 percent wanted welfare and social services cut a lot. Similar findings obtained for non-Californians.

[2]See, for example, the *Washington Post* (October 1, 1978) and the *Gallup Opinion Index* (September 1977).

Believing that many services are inessential or inefficiently provided, a sizable fraction of the electorate (including the supporters of Prop. 13) felt that taxes could be cut without endangering "basic" or "essential" services (Ladd et al., 1979, p. 134). The most desired local services are generally police, fire, sanitation, and street repair, followed by basic educational services, all traditional functions of local government that benefit almost the entire population.

Citizens also have strong opinions on different types of taxes. Generally, they feel that the property tax is the least fair, followed closely by state and federal income taxes, while sales taxes are considered the most fair.[3] The property tax is levied on wealth, not on income or consumption, and so it hits hard on those homeowners (e.g., retired persons) with permanently or temporarily low incomes. Moreover, when reassessments follow rapidly rising property values--emphatically the case in California before Prop. 13--property levies tax unrealized capital gains. Most homeowners can realize these gains only by selling and moving out.[4]

Some observers have interpreted the "tax revolt" as a drive to redress the balance between the public and private sectors, an attempt to prevent ever-increasing shares of income from being spent by the government instead of by those who earn it. This is consistent with a conservative view of government: that it should be small and decentralized, intervene little in daily life (e.g., avoid regulating private activities), and provide traditional basic services rather than redistribute income to "needy" persons or "worthy" activities. The last suggests a middle-class tax revolt, aimed at cutting services for the poor or minorities (e.g., welfare) that the middle class must support but does not directly benefit from.

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[3] See, e.g., ACIR (October 1977, p. 11), and *Newsweek* (1978, p. 22), the latter reporting on a Gallup Poll taken after the passage of Prop. 13.

[4] Property taxes were hated in the 1930s, too, when they forced many out of home ownership. From a Woody Guthrie song: "As through this world you wander, you'll meet lots of funny men/Some will rob you with a six-gun and some with a fountain pen./But as through this world you wander, as through this world you roam/You won't never see an outlaw drive a family from their home."

Similarly, many observers have interpreted the tax revolt and other political trends as signifying a new attitude about the responsibilities of government. They support California Governor Brown's belief in an "era of limits," in which citizens should not expect government to solve all their problems, and government should not try. The discipline of the marketplace and voluntary action should substitute for those political and bureaucratic processes that make government inefficient and ineffective.

This report does not resolve the debate on the tax revolt. Instead, it addresses certain factual questions underlying the causes and consequences of fiscal containment in its many guises, and indicates issues most in need of further research. To understand the current pressure for fiscal restraint, one must:

- *Explore recent trends in state and local spending.* For example, has a disproportionate increase in services been devoted to the poor and to minorities, with a corresponding deemphasis of universalistic, traditional, or basic services? Is there any sign of increased inefficiency in government?
- *Investigate changes in taxation by subnational governments.* Property taxes are a prime target of tax reformers. Has their role in government finance increased or decreased?
- *Examine state and local fiscal constraints.* What are the legal mechanisms by which subnational taxing and spending have been limited in the past, and currently? Has fiscal containment been achieved by the election of more frugal politicians or declines in the revenue base?
- *Understand the long-term consequences of political and other trends that restrict government.* Will they succeed in altering the relative position of competing groups in the electorate? Will they alter long-standing political relationships, such as those between state and local governments?

In regard to the last point, we have chosen to concentrate on the social and political effects of containment because it seemed to us a

relatively unexplored topic. Other researchers are studying the consequences for government operations, the economy, housing construction, and land-use patterns.

Chapter 2
TRENDS IN STATE AND LOCAL FINANCE

This chapter outlines the changes in public finance that have accompanied government growth between 1929 and 1975. An examination of the long-term trends in the size of government, taxing, and spending will shed light on the factual justification for the public attitudes summarized in Chap. 1. After concluding that many of these attitudes are justified, we suggest reasons for the containment of past growth that has occurred since the mid-1970s. Although this chapter frequently compares the three levels of government, it emphasizes state and local levels.

GROWTH IN ALL LEVELS OF GOVERNMENT

The public perception is accurate that the size of government has grown dramatically. Measured by their spending, all levels of government--local, state, and federal--have grown rapidly in the last half-century, averaging 9 percent per year in current dollars. (See Table 2.1, which includes spending arising from intergovernmental transfers. Local figures include school districts.) Some of this growth has been forced by inflation and some is the result of population expansion, but dividing spending by the Consumer Price Index and population still shows a ten-fold increase in 50 years, corresponding to a 5-percent real annual growth rate per capita (Table 2.2).

With rare exceptions, all levels of government have grown throughout this period, though the rate of growth has varied through time and according to the level of government. Table 2.2 shows that from 1929 to 1949 the federal government grew far faster than state and local governments; since 1949 subnational governments have grown faster. We also see a slowing of growth in subnational governments since 1975, particularly localities. We will have more to say on this topic later.

Disproportionate growth of the federal government from 1929 to 1949 increased the federal share of all public sector spending from about one-fourth to two-thirds. Though this share later diminished

Table 2.1

GOVERNMENT SPENDING, AFTER INTERGOVERNMENTAL TRANSFERS, 1929-1979

Calendar Year	Federal	State	Local	All Levels
	Billions of Current Dollars			
1929	3	2	6	10
1939	8	3	7	17
1949	39	8	13	59
1959	84	18	29	131
1969	168	44	73	286
1975	302	90	141	533
1979[a]	429	138	198	765
	Annual Percentage Change			
1929-39	12.2	5.8	0.8	5.5
1939-49	17.3	9.9	6.6	13.0
1949-59	8.0	8.6	8.9	8.2
1959-69	7.2	9.8	9.5	8.1
1969-75	10.3	12.4	11.6	11.0
1975-79	9.2	11.4	8.8	9.4
1929-79	10.8	9.2	7.2	9.0

SOURCE: Advisory Commission on Intergovernmental Relations (ACIR), *Significant Features of Fiscal Federalism*, 1978-79 ed., Washington, D.C., May 1979, p. 9.

NOTES: The table uses definitions found in national income and product accounts. Details may not add to totals because of rounding. Rates of change were computed from more detailed figures than shown.

[a]Estimated in source.

(to 56 percent), Washington still spends more than state and local governments combined. The greatest turnabout has occurred in the role of local governments. In 1929, localities were the heaviest-spending level of government, exceeding the states and Washington combined (Table 2.1). Now localities spend far less than the federal government. As mentioned, Tables 2.1 and 2.2 include all spending, whether from a government's own funds or intergovernmental transfers received. It will

Table 2.2

REAL GOVERNMENT SPENDING, PER CAPITA, 1929-1979

Calendar Year	Federal	State	Local	All Levels
	1967 Dollars[a]			
1929	40	27	97	163
1939	145	55	121	320
1949	366	72	117	555
1959	542	113	189	844
1969	755	200	328	1283
1975	878	261	409	1548
1979[b]	919	296	423	1638
	Annual Percentage Change			
1929-39	13.7	7.3	2.2	7.0
1939-49	9.7	2.7	-0.3	5.7
1949-59	4.0	4.6	4.9	4.3
1959-69	3.4	5.9	5.7	4.3
1969-75	2.5	4.5	3.7	3.2
1975-79	1.1	3.2	0.8	1.4
1929-49	11.7	5.0	0.9	6.3
1949-79	3.1	4.8	4.4	3.7
1929-79	6.5	4.9	3.0	4.7

SOURCE: ACIR, *Significant Features of Fiscal Federalism*, 1978-79 ed., Washington, D.C., May 1979, p. 9.

[a] Consumer Price Index.

[b] Estimated in source.

be seen that much of local spending is supported by state and federal transfers. Netting these out, localities will spend an estimated 113 billion dollars from their own sources in 1979, only 15 percent of all public spending, and less than either state or federal own-source spending (ACIR, 1979, p. 7).

The growth in government spending has outdistanced growth in the national economy: The public sector has expanded faster than the

private sector. Consequently, Table 2.3 shows that government spending as a share of GNP almost doubled during the 1930s, and has almost redoubled since then. The public sector now spends a third of GNP.

Since 1975, however, growth in no level of government has outdistanced the increase in GNP. The restrained growth in federal and local governments has actually reduced their size relative to GNP. Somewhat less of a restraint in the growth of state government has made it just keep pace with GNP since 1975, unlike the previous postwar period.

Expansion of spending of course leads to more taxes. When the public sector grows faster than the private, taxpayers' burdens (relative to their income) must also rise. Citizens' perceptions of increased tax burdens have been sharpened by the coincidence of three trends: (1) increases in real taxes and fees, (2) increases in taxes and fees relative to personal income, and, recently, (3) frequent double-digit inflation and slow growth in the private economy (Table 2.4). With rapid growth in real incomes, steep tax increases take only an additional piece of a growing pie. After-tax incomes still grow. On the other hand, static real incomes make an increased tax bite far more painful.

Perhaps the most tangible indication of government expansion is the rapid growth in the number of public employees: an increase of 2.5 times between 1949 and 1977 (Table 2.5). Government employment grew faster than private employment, rising from 14 to 19 percent of nonagricultural workers.[1] However, postwar employment patterns of different levels of government contrast with the expenditure patterns observed. Federal employment has trended downward since the late 1960s and has decreased relative to private employment for the last thirty years. State and local employment has tripled since 1949, however, making it the fastest growing sector in the economy. Chapter 1 mentioned the popular perception of a swollen civil service, but only subnational governments have increased their staffs since 1969. State

[1]The public sector's share of the national work force is less than its share of GNP because much federal spending (e.g., defense) purchases goods and services produced by the private sector.

Table 2.3

GOVERNMENT SPENDING, AFTER TRANSFERS, RELATIVE TO GNP

Calendar Year	Federal	State	Local	All Levels
	Percent of GNP			
1929	2.4	1.6	5.9	9.9
1939	8.7	3.3	7.3	19.2
1949	15.2	3.0	4.8	23.0
1959	17.3	3.6	6.0	26.9
1969	18.0	4.7	7.8	30.5
1975	19.8	5.9	9.2	34.9
1979[a]	18.3	5.9	8.4	32.6
	Annual Percentage Change			
1929-39	13.7	7.5	2.2	6.8
1939-49	5.7	-0.9	-4.1	1.8
1949-59	1.3	1.8	2.3	1.6
1959-69	0.4	2.7	2.7	1.3
1969-75	1.6	3.9	2.8	2.3
1975-79	-2.0	0.0	-2.2	-1.7

SOURCE: ACIR, *Significant Features of Fiscal Federalism*, 1978-79 ed., Washington, D.C, May 1979.

[a]Estimated in source.

Table 2.4

REAL GNP PER CAPITA, 1929-1978

Calendar Year	Real GNP Per Capita[a]	Average Annual Percentage Change Over Specified Periods
1929	$2584	-0.6
1939	2442	3.0
1949	3287	2.2
1959	4068	2.8
1969	5356	1.7
1978[b]	6236	

SOURCES: U.S. Bureau of Economic Analysis, *National Income and Product Accounts*, and *Survey of Current Business*, February 1979; U.S. Bureau of the Census, *Statistical Abstract*, 1978.

[a]GNP deflator, 1972 dollars.

[b]Preliminary.

and local employees (particularly the latter) are generally more visible to the public than are federal workers, however.

Average real compensation (wages, salaries, and the estimated value of fringe benefits) have grown faster for public than for private employees (Table 2.6). From 1949 to 1978, real compensation grew at the rate of 2.8 percent annually for civilian federal employees and 2.5 percent for state and local employees, but grew slower (2.2 percent) in the private sector.[2] Not only has the compensation of federal civilian employees grown faster than that of other public employees, but federal employees also currently average $3400 a year more compensation than in the private sector. Of course, this crude comparison of average compensation (and its growth rate) overlooks skill differences. Chapter 3 below shows that, from 1973 to 1978, the increase in average compensation for Los Angeles employees was partly due to growth in the proportion of employees assigned to higher skill levels.

Increases in fringe benefits have played an important role in public employees' compensation growth. The same data sources as those of Table 2.6 show that from 1949 to 1978 the real fringe benefits of federal civilian employees grew 7.3 percent annually (and those of state and local employees 7.1 annually), faster than the 6.6 percent growth in the private sector. From 1975 to 1978, wages and salaries for subnational employees fell behind inflation; however, their real fringe benefits continued to increase, not only faster than inflation, but faster than the rest of the economy.

Increases in public employees' retirement benefits, an important part of fringe benefits, have received much publicity, particularly when they are part of collective bargaining agreements. These benefit increases have contributed to the unfunded liabilities of many public pension plans, a potential problem for the future. Moreover, pension

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[2] The compensation growth rate for the entire public sector is lower than that for either federal civilian or state and local employment. This is because the faster employment growth in the latter has skewed the employment mix away from the higher-paid federal civilian employees. Also, military employment in 1969 caused the average compensation in the public sector to be lower than either of the two details tabulated.

Table 2.5

NUMBER OF GOVERNMENT EMPLOYEES, 1949-1977

Calendar Year	Federal	State	Local	All Levels
Full-time and Part-time Employees (thousands)[a]				
1949	2,047	1,037	3,119	6,203
1959	2,399	1,454	4,634	8,487
1969	2,969	2,614	7,102	12,685
1977	2,848	3,467	9,091	15,406
Annual Percentage Change				
1949-59	1.6	3.4	4.0	3.2
1959-69	2.2	6.0	4.4	4.1
1969-77	-0.5	3.6	3.1	2.5
Government Employees as Percent of All Employees[b]				
1949	4.7	2.4	7.1	14.2
1959	4.5	2.7	8.7	15.9
1969	4.2	3.7	10.1	18.0
1977	3.5	4.2	11.1	18.8

SOURCES: U.S. Bureau of the Census, *Statistical Abstract*, 1978, and *Historical Statistics*, 1975.

[a] During October. Civilian employees only.

[b] Base is all nonagricultural civilian employees.

increases are popular with politicians, because their budgetary impacts will be felt only in the future and therefore will not be associated with the current administration.

TAXING AND SPENDING IN STATE AND LOCAL GOVERNMENTS

Taxing

The remainder of this chapter discusses state and local governments, the focus of this report. State and local finances vary widely across the nation. Some states have broad-based income taxes; some have general sales taxes; one (New Hampshire) has neither. The property tax is by far the most important local tax, but its role also varies across

Table 2.6

REAL COMPENSATION BY SECTOR OF THE ECONOMY PER FULL-TIME-EQUIVALENT EMPLOYEE

Calendar Year	Private Sector	Public Sector			All Domestic[b]
		Federal Civilian[a]	State and Local[a]	All[b]	
Annual Wages, Salaries, and Estimated Fringe Benefits[c]					
1949	4,219	5,089	3,919	4,233	4,221
1959	5,870	7,224	5,381	5,478	5,797
1969	7,317	9,604	7,335	7,138	7,281
1975	7,676	10,933	7,747	8,085	7,760
1978	7,941	11,353	7,948	8,258	8,001
Annual Percentage Change					
1949-59	3.4	3.6	3.2	2.6	3.2
1959-69	2.2	2.9	3.1	2.7	2.3
1969-75	0.8	2.2	0.9	2.1	1.1
1975-78	1.1	1.3	0.9	0.7	1.0
1949-78	2.2	2.8	2.5	2.3	2.2

SOURCE: U.S. Bureau of Economic Analysis, *The National Income and Product Accounts of the United States, 1929-1974*, Tables 6.6 and 6.8; *Survey of Current Business*, July 1977, 1978, 1979.

[a]Excludes military and government enterprises.

[b]Includes military and government enterprises.

[c]Consumer Price Index, 1967 dollars.

the country and with the type of local jurisdiction. The overall level of taxation varies widely as well. In fiscal 1977, Alaska, New York, California, and Wyoming were the most heavily taxed states, with state and local taxes (excluding nontax revenues) amounting to 24, 18, 16, and 16 percent of personal income, respectively. The national average was 13 percent. At the other extreme, Alabama, Arkansas, Missouri, and Ohio levied taxes at the rate of only 10 percent of personal income. In general, Sunbelt states are less heavily taxed than elsewhere, both in dollar terms and relative to personal income, the latter averaging 11 percent in fiscal 1977.

Property Taxes. Though its importance has been reduced by intergovernmental transfers, the property tax still provides the bulk of locally collected taxes, accounting for 81 percent in fiscal 1976. Reliance on the local property tax varies across states and with different types of localities. In fiscal 1976, cities drew 61 percent (and those of a half-million or more population drew only 53 percent) of their own-source taxes from property levies; counties depended on property taxes to the extent of 82 percent. In other types of jurisdictions (notably school districts and special districts), property taxes provided a higher than average share of own-source tax revenues.[3]

Though their role in local finance has diminished, property tax collections (in current dollars) increased by 4.8 times between 1958 and 1978. Our estimates indicate that only 11 percent of this increase was due to growth in effective tax rates, while an approximately 415-percent inflation in nominal property values, together with more efficient reassessments, caused 89 percent of the increase. Average effective property tax rates increased from 1.34 percent in 1958 to 1.98 percent in 1971. Thereafter, they *decreased* to 1.56 percent in 1978, somewhat faster than the rate at which they increased.[4] One cause of the decrease in tax rates is "the truth in property taxation" measures several states enacted, which require explicit public justification for increases in property tax collections as well as for heightened tax rates. The fiscal limitation measures discussed in Chap. 4 are another cause. These measures, combined with public awareness of increasing collections, may have restrained soaring property tax revenues.

Other Taxes. Most of the states' own-source tax revenues are from four taxes: individual income taxes, corporate income taxes, general sales and gross receipts taxes, and selective sales and gross receipts

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[3]U.S. Bureau of the Census, *Statistical Abstract of the United States*, 1978, pp. 293, 309, 311. As will be seen, much of school revenue comes from state and federal transfers, but these are not own-source taxes.

[4]Tax rates are on existing single-family homes with mortgages insured by the Federal Housing Administration, summarized in ACIR, 1979, pp. 45, 56.

taxes, the last including "sin" taxes (liquor and tobacco) and gasoline taxes.

Individual income and general sales taxes have yielded increasingly larger shares of state tax levies. They accounted for 8 and 22 percent in 1949, rising to 24 and 31 percent by 1976. In this period, 11 states enacted individual income taxes and 17 states enacted general sales taxes (ACIR, March 1977, pp. 10, 99-105).

Rapid inflation differentially affects the yields of taxes of various types. Most progressive individual income taxes have not been indexed to inflation, that is, the tax brackets do not automatically move with the price level. Strictly inflationary increases in income then push taxpayers into higher tax brackets, which raises tax proceeds and reduces real, after-tax income. One review found that a 1-percent increase in individual income augmented tax collection by 1.3 to 2.4 percent, depending on the tax schedule, of course (ACIR, March 1977, p. 254). These figures--the income elasticity of tax proceeds--were much lower for other taxes, frequently less than one and rarely much over.

State surpluses. Perhaps as a consequence of inflationary increases in tax revenues, perhaps because of recently slowed increases in state spending, perhaps because of a fear of recession-induced deficits, many states have amassed considerable surpluses of revenues over expenditures. California's accumulated surplus, the largest nationwide, is widely held to have encouraged the passage of Prop. 13. If the governor and legislature could not agree on how to return excess collections, the people could act by cutting local taxes and thereby force a state financial rescue of local government. Some of the surplus was in fact redistributed when the state "bailed out" localities, restoring much of the lost property tax revenues. But state surpluses are not limited to California. At the end of 1978, by one estimate, they totaled $8.9 billion nationwide, 9 percent of 1978 state expenditures (National Governors Association, 1979).[5] Thirteen states had surpluses greater than 20 percent of their 1978 expenditures; five states' surpluses exceeded 20

[5] As the debate over the size of California's surplus during the campaign for Prop. 13 shows, surpluses are hard to define and measure. The cited study referred to "actual operating balances."

percent. In dollar terms, Alaska, California, and Texas have had the largest surpluses.

Some have argued that state surpluses stimulate the drive to cut taxes because their existence implies that service reductions need not accompany revenue losses (see, e.g., Kirlin and Chapman, 1978); but most surpluses have accumulated over the years and will eventually disappear as states spend or transfer to localities more than they receive in annual revenues. The decline in surpluses will be speeded, of course, by the imposition of indexing or other devices that decrease the income elasticity of state revenue systems. Kimball (1978) estimates that with reasonable assumptions about future bail-out arrangements and the course of the state economy, the currently enormous California state surplus will dwindle to a merely prudent reserve within a few years. Gramlich (1978) argues that generally the current bulge in state surpluses is a temporary phenomenon attributable to a buildup in pension funds, a drop in construction of state facilities, and the predictable effect of a cyclical boom in the economy.

Intergovernmental Transfers. While subnational governments have raised increasing amounts of revenue from their constituents, an important feature in their expansion has been the growth in intergovernmental transfers: from Washington to states and localities, and from state capitals to localities. These transfers have grown faster than revenues collected from states' and localities' own sources, that is, from their own constituents (Table 2.7). As a result, financing has grown more centralized. This trend has permitted the work forces and programs of subnational governments to grow faster than their own taxes, a politically desirable phenomenon. In 1978, federal aid to states was almost 40 percent of own-source revenues, while the federal and state contributions to localities were three-quarters of own-source revenues (Table 2.8). Federal aid to subnational governments amounted to $60 per person in 1965; by 1978 this quantity had more than tripled to $191 (figures in constant 1967 dollars). From 1969 to 1977, increases in federal assistance to states and localities accounted for a third of expenditure growth. The role of intergovernmental transfers in local finance, particularly for schools, large cities, and counties is even greater. More

Table 2.7

INTERGOVERNMENTAL TRANSFERS TO STATE AND LOCAL GOVERNMENTS AS A PERCENTAGE OF GENERAL REVENUES FROM OWN SOURCES

Fiscal Year	Federal Aid to States	Federal & State Aid to Localities
1948	21.9	44.5
1959	32.4	42.2
1969	34.1	56.9
1973	39.0	67.9
1978	38.8	76.0

SOURCE: ACIR, *Significant Features of Fiscal Federalism*, 1978-79 ed., Washington, D.C., May 1979.

NOTE: General revenues exclude those collected by government-owned utilities, liquor stores, and insurance trusts.

Table 2.8

FEDERAL AND STATE AID TO DIFFERENT TYPES OF LOCAL GOVERNMENTS

Type of Jurisdiction	Fiscal Year	Federal and State Aid as Percentage of General Revenues from Own Sources
All localities	1977	75.4
Municipalities	1977	62.9
School districts	1977	97.4
All cities	1976	67.2
Less than 100,000 persons	1976	49.9
100,000 to 499,999 persons	1976	63.3
500,000 persons and over	1976	84.9
All counties	1976	82.3
Less than 100,000 persons	1976	88.1
100,000 to 299,999 persons	1976	87.9
300,000 persons and over	1976	77.2

SOURCE: ACIR, *Significant Features of Fiscal Federalism*, 1978-79 ed., Washington, D.C., May 1979; U.S. Bureau of the Census, *City Government Finances in 1975-76*, Series GF76, No. 4, and *County Government Finances in 1975-76*, Series GF76, No. 8.

than half of all state aid to localities is for education; welfare is next in importance.

Though aid from higher levels of government is by now ubiquitous, its budgetary importance varies geographically, as well as with the type of jurisdiction. In 1977, New Mexico localities received almost twice as much state and federal aid as own-source general revenues. At the other extreme, New Hampshire localities received grants amounting to but one-third of own-source revenues.

Spending

As state and local budgets expanded, virtually all activities received additional funds, but not at the same rate; consequently, the resulting distribution of expenditures changed. Table 2.9 classifies state and local direct expenditures as those generally oriented to disadvantaged persons (welfare, health and hospitals, housing and urban renewal), those for education, and those for more universalistic or "basic" services: highways (including street maintenance), police, fire, natural resources, sanitation, and parks. From 1956 to 1976, the universalistic services received a generally smaller share of expenditures, while health and (especially) welfare expenditures increased disproportionately. During this period, those who received Aid to Families with Dependent Children (a variety of welfare) grew from 1.3 percent to 5.2 percent of the population.

Total educational spending maintained a fairly constant share of expenditures. However, the basic component of education, local schools, received a diminished share even though the number of children attending local schools rose faster than the total population, increasing from 31 million in 1956 (18 percent of the population) to 45 million in 1976 (21 percent of the population). Expenditures for higher education and other education grew especially fast, rising from 6 to 12 percent of aggregate state and local spending.

Higher education and public assistance tend to benefit more narrowly constituted subpopulations than do such programs as the building and maintenance of highways and streets (whose share has been reduced), which are enjoyed by a broad range of taxpayers. Federal aid programs,

Table 2.9

PERCENTAGE DISTRIBUTION OF DIRECT GENERAL EXPENDITURES BY STATE AND LOCAL GOVERNMENTS

Function	Fiscal Year 1956	1973	1976
Public welfare	8.6	13.0	12.3
Health and hospitals	7.6	7.6	8.1
Housing and urban renewal	1.2	1.7	1.2
Total	17.4	22.3	21.6
Local schools	30.4	26.9	26.5
Higher education	4.8	9.6	9.5
Other education	0.8	2.0	2.1
Total	36.0	38.5	38.1
Highways	18.9	10.3	9.4
Police protection	3.6	3.7	3.7
Local fire protection	2.0	1.5	1.5
Natural resources	2.5	1.8	1.8
Sanitation and sewerage	3.6	2.9	3.2
Local parks and recreation	1.5	1.4	1.4
Total	32.1	21.6	21.0
Other	14.5	17.6	19.3
Total, all functions	100.0	100.0	100.0

SOURCE: U.S. Bureau of the Census, *Governmental Finances*, Series GF, No. 5, annual.

NOTE: Excludes government-owned utilities, liquor stores, and insurance trusts, as well as a small amount of transfers to the federal government. Details may not add to totals because of rounding.

many of which assist disadvantaged persons, encouraged this shift away from universalistic services. In fiscal 1978, a third of Washington's aid to state and local governments was for income security (e.g., welfare) or health (e.g., Medicaid) programs.

CONCLUSIONS: LONG-TERM TRENDS

The figures presented here are generally consistent with public attitudes critical of government. Government *has* been growing, as evidenced by increases in taxes, spending, and the public work

force. An enlarged share of the GNP, about a third, supports the public sector at the same time that inflation has slowed real growth in the private economy.

Progressive income taxes that are not indexed to the price level particularly penalize taxpayers during inflationary times. Surpluses have appeared in many state treasuries. Although the accumulation of a surplus may be viewed as prudent financial management, angry taxpayers may feel nevertheless that the state is unjustifiably taking in more money--more of their money--than it is devoting to citizens' services.

Public finance is more centralized than before, supporting fears of huge, distant, uncontrollable government. The federal government now accounts for two-thirds of all own-source public spending; the fraction was one-fourth 50 years ago. States now account for 56 percent of all subnational spending from own sources, twice the 1929 figure (ACIR, May 1979, p. 7). (Current figures are ACIR estimates for calendar 1979.) While total spending and public employment are less centralized than these figures suggest, because of state and federal transfers, they may raise fears of declining local autonomy.

Lacking measures of public employees' productivity or detailed salary information, one cannot directly assess the frequent criticism that there are too many public employees and that they are overpaid in the bargain. Public employment has swelled during the last twenty years, particularly in state and local government, which, measured by employment growth, is the fastest growing sector in the economy. Earnings of public employees (and particular their fringe benefits) have generally grown faster than those of workers in the private sector; federal employees average higher earnings than those in nongovernmental occupations.

While the unpopular property tax is still clearly the most important source of locally levied and locally collected revenue, intergovernmental transfers have reduced its role in local public finance. Nevertheless, frequent and efficient reassessments in many localities automatically translate inflation in property values into an increased tax burden, thus taxing a capital gain that is as yet unrealized. Although skyrocketing property values (and hence tax collections) were

an important cause of the passage of Prop. 13, less publicized growth in property values has occurred elsewhere. From 1958 to 1978, nationwide growth in assessed values accounted for 89 percent of increased property tax collections. Rate increases accounted for only 11 percent, and average property tax rates have been *decreasing* since 1971, slightly faster than they previously increased.

Although virtually all government functions have expanded, redistributive programs targeted on disadvantaged groups--especially welfare and health--have grown faster than universalistic programs--e.g., police and fire protection--that provide services for all. Much federal aid to state and local government is redistributive, such as public assistance and Medicaid.

These trends show possible bases for a middle-class tax revolt: Government has grown larger and more centralized, while real income growth has slowed, and a greater share of the middle-class tax dollar benefits the disadvantaged, not the middle class.

Careful analysis must look at the *current* rate of growth in the size of government and public employment (to cite two examples), and not merely at historical trends. Federal spending has recently just kept pace with the national economy, and has not expanded its share. The federal work force has actually shrunk, and the wages and salaries of public employees at all levels of government have barely stayed abreast of inflation. Growth in state and local governments has been curtailed since about 1975.

RECENT CONTRACTIONARY PRESSURES

Five reasons explain the recently slowed growth in state and (especially) local government. First, in the 1970s, 23 states enacted statutes or constitutional amendments limiting taxes or spending. Chap. 4 discusses these measures. Second, while state and, even more so, local governments have become increasingly dependent on intergovernmental transfers, the growth in transfers to localities has slowed. Slowed growth in transfers reflects the slowed growth in the state and federal governments that are their sources. Third, the tax base in many localities (and some states) has shrunk as the households and firms on whom

the tax collector once depended have sought new opportunities, better amenities--and lower taxes--in the suburbs and the Sunbelt states. Fourth, sketchy evidence suggests a newly frugal electorate that has voted in more tightfisted officials. Fifth, Chap. 1 has summarized evidence that voters increasingly distrust not only government, but the efficiency and effectiveness of public spending. These attitudes may underlie the passage of fiscal limitation measures and the election of parsimonious politicians.

Table 2.10's detailed time series illustrates the second source of contractionary pressure. Measured in constant dollars, the growth rate in transfers to local government has recently been halved. Since 1975, transfers have grown 4.5 percent annually; from 1959 to 1974, they grew at a rate of 9.1 percent. And state and federal aid as a share of own-source revenues has only inched up in the latter 1970s. Peterson (1976) argues that the mid-1970s are "likely to appear as the federal government's peak period of largesse toward the cities."

In the same study, Peterson also investigates the erosion of big-city tax bases. Cities collect most of their own-source taxes from the people who live in them. Of the 60 cities that had populations of 200,000 or more in 1960, 73 percent had declined in size by 1973. During these 13 years, Buffalo, Cleveland, St. Louis, and Pittsburgh lost one-fifth of their total populations.

In consequence, Peterson argues, the property tax base (exclusive of assessment practices) in declining cities has failed to keep pace with public spending (although average income levels in these same cities--another indication of fiscal capacity--have not done as badly). Poor performance in the property tax base is primarily attributable to the reduction in demand for housing that accompanies population loss, but also to the out-migration of business enterprises. The result has been a rise in property tax rates for the smaller population of firms and households in the declining big cities, which in turn dims prospects for future municipal growth.[6]

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[6]The households and firms lost to these cities obviously end up on the tax rolls of other jurisdictions, which are disproportionately low-spending localities in the suburbs, the South, and the West. Consequently, the net effect on aggregate local government fiscal activity is probably negative.

Table 2.10

STATE AND FEDERAL AID TO LOCAL GOVERNMENT, 1948-1978

Fiscal Year	Millions of Inflation-Adjusted Dollars (1967 = 100)	Aid as a Percent of Local General Revenues from Own Sources
1948	4856	44.5
1954	7370	43.5
1959	10010	42.2
1964	14886	45.7
1969	23754	56.9
1970	25386	57.5
1971	28420	60.0
1972	31679	60.6
1973	35977	67.9
1974	37070	71.3
1975	38446	73.5
1976	40908	74.8
1977	42120	75.4
1978	43891	76.0
Average Annual Rates of Growth		
1948-59	6.8	-0.4
1959-69	9.0	3.0
1970-74	9.9	5.5
1975-78	4.5	1.1

SOURCE: D. L. Puryear and J. P. Ross, "Tax and Expenditure Limitations: The Fiscal Context," paper presented at the HUD Conference on Tax and Expenditure Limitations, University of California, Santa Barbara, December 14-15, 1978.

NOTE: Aid figures in the original were given in current dollars; they are deflated above by the Consumer Price Index.

Population losses do not translate into declines in the cost of government because existing (and rapidly aging) infrastructures require maintenance, and abandoned neighborhoods often need even more police and fire services. Public payrolls are difficult to reduce and accumulated pension obligations cost more each year.

With stagnation and out-migration, the character of the population also changes; those remaining need higher per capita levels of protective, health, and social services. Ironically, according to Peterson,

the declining big cities have also traditionally spent more on public services than have their still-growing counterparts, mostly because they hire more workers and pay higher wages for performance of the same functions. The squeeze for older cities will be the more painful.

Voting on state and local bond issues evidences more frugal attitudes in the electorate. A 1976 study (ACIR) found that, from 1969 to 1974, voters approved 53 percent of the value of the bond issues they were asked to vote on; that figure dropped to 29 percent in 1975. *U.S. News and World Report* (November 17, 1975) and *Time* (November 21, 1977) call attention to an apparent change of heart among voters in recent years in their voting on both local tax overrides and bond issues. Infrastructure improvements as well as new or expanded services are beginning to get a negative response from local electorates. The reports in the news magazines are based on impressionistic data from nonrandom samples of localities; the scholarly literature seems to contain no systematic analysis of this topic other than the study cited.

Nor have political scientists explored possible recent shifts in the spending propensities of elected local officials. One commentator (Boyarsky, 1979) reports that a block of militant anti-spenders was elected to the California assembly on the coattails of Proposition 13. If, as seems likely, the decision to vote "No" on a tax override is associated with a preference for an economy-minded city council candidate, a change in the makeup of the officialdom of local government probably has occurred in the direction of greater parsimony with public funds. But no nationwide data are available, because indicators of the spending attitudes of mayors, council members, and county supervisors are difficult to devise.

This chapter has sketched both the postwar growth in local government and the mid-1970s containment of that growth. The next two chapters elucidate aspects of these two phenomena. Chapter 3 explores Los Angeles's fiscal expansion prior to Prop. 13. It reviews the ways in which the pre-containment increase was spent. Chapter 4 examines the fiscal limitation measures that have helped to contain past expansion.

Chapter 3
TRACKING GROWTH IN MUNICIPAL EXPENDITURES: A CASE STUDY OF LOS ANGELES[1]

Two considerations led us to undertake a case analysis of municipal expenditure trends; both relate to fiscal limitation. First, as we argue elsewhere in this report, voter dissatisfaction with the cost/benefit balance in municipal government becomes a stimulus to the adoption of measures designed to control local expenditures. Thus it is important to understand what city residents have been getting in exchange for their additional tax dollars. Second, fiscal limits imposed on local government will constrain future municipal spending. Forecasting the direction and consequences of cutbacks requires knowledge of the ways in which inflation and changes in the magnitude and composition of inputs have affected municipal budgets in recent years.

The City of Los Angeles was chosen as the site for a case study both because it is the largest municipality in California, where fiscal limitation has struck most dramatically, and because data were accessible at moderate cost. City officials in fact invited us to undertake the study.

In budget composition and dynamics, Los Angeles seems typical of most cities in the state. Financial reports prepared by the City Controller reveal that Los Angeles property tax receipts increased 53 percent between 1972-73 and 1977-78, from $222 to $340 million; total revenues (including transfers) increased from $621 to $1,066 million (72 percent). To the extent that what occurred in Los Angeles was mirrored in other California cities, the effects of Proposition 13 might also be similar throughout the state. As for cities in the rest of the nation, we can demonstrate that the consequences of inflation on municipal costs largely paralleled the Los Angeles experience (Chaiken and

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[1]The authors of the Rand publication from which this chapter was adapted (Jan M. Chaiken and Warren E. Walker, *Growth in Municipal Expenditures: A Case Study of Los Angeles*, N-1200-RC) wish to express special thanks for the assistance of Michael Caggiano.

Walker, 1979), although only individual case studies can reveal whether the other sorts of budget increases, such as the changes in the mix of activities and the "upward" float in employee composition discovered in Los Angeles, also obtained.

INTRODUCTION

In the last decade, state and local government expenditures have increased faster than inflation (as detailed in Chap. 2). At the same time, members of the public were complaining about inadequate or unresponsive government services and expressing the view that there is too much "fat" in government. At least in part, Prop. 13 can be viewed as a forceful attempt to put a stop to these increases in expenditures, but there has been no clear answer to the question of what, exactly, constituted the "undesirable" increases.

A detailed portrait of the expenditure increases is needed to clarify some of the main implications of the fiscal limitation movement. To the extent that these increases are simply a reflection of inflationary pressures equal to those in the private sector, revenue reductions cannot be sustained for long without cutbacks in the delivery of services. But to the extent that expenditure increases reflect growing inefficiency in government or the addition of activities that the voters do not want government to perform, fiscal limitation may lead to stabilization or reduction of such components. In addition, a detailed portrait will serve to differentiate among expenditure trends that are obscured when all types of governments are considered together. For example, it will illuminate important differences in expenditure trends among municipal governments, or between cities and counties.

The work described here constitutes some preliminary steps toward such a detailed portrait. We have developed a method for dividing expenditure increases into categories that are both conceptually meaningful and quantifiable using local government data resources that are typically available. We have applied the method to Los Angeles, with the intent that it could be generalized for future analyses, using data from other local jurisdictions. The details of our findings may be unique to Los Angeles, but we point out when our numerical results appear consistent with statewide or nationwide trends.

SUMMARY OF APPROACH AND FINDINGS

Our analysis draws on many data sources, including Los Angeles City budget materials and published analyses of expenditures in other cities around the nation. The basic approach is to identify the total growth in the city's expenditures over a five-year period (1973 to 1978) and then to explain the components of growth within categories. The following categories are used in making this subdivision of expenditure changes:

- *Service Levels.* In principle, service levels are the outputs of the entire government, but in practice one is often forced to draw inferences about them by examining proxy measures such as the input levels for agencies that provide services. Included among changes in service levels are changes in the number of units of work performed, addition of new programs or activities not previously performed by the jurisdiction, elimination of programs, and shifts from low-cost to high-cost activities.
- *Inflation.* Inflation affects the prices of the goods and services that the jurisdiction purchases, which differ substantially from those purchased by consumers or other groups for which national and local price indexes are calculated. Under certain economic conditions, jurisdiction-specific price indexes can increase faster than general price indexes, such as those for consumers.
- *Productivity, or cost per unit of service.* Expenditure changes in this category represent changes in the real cost of providing a fixed level of service. These occur when the "production function" for municipal goods shifts--as a result, for example, of degradation in efficiency. In principle, these can be determined by carefully measuring the quantities and prices of goods and services purchased in a large number of categories. We have roughly estimated real cost changes by examining the residual expenditure increases, after inflation and service-level changes have been taken into account.

Analyses using approximately these same categories have been conducted previously for New York City (Greytak et al., 1974; Brecher, 1974) and for 23 medium-sized Illinois cities (Walzer, 1970; Walzer and Stratton, 1977), and substantial work has been carried out using more broadly based state and national statistics. However, as Greytak (1978) recently stated, "The available evidence about the cost and expenditures of local governments is sufficient to support only those conclusions which are of a general nature. More explicit statements would require detailed analysis of local government fiscal documents." This was our intent in exploring the data from Los Angeles.

Our analysis, detailed in the sections that follow, proceeds in the following manner.

1. We first establish that only a small portion of the expenditure growth can be attributed to a growth in the city work force. In fact, the total number of regular city employees has been decreasing in recent years. However, the relationship between regular employees and total expenditures is slightly clouded by a large increase in the number of federally funded city employees.

2. Next we argue that the small changes in the size of the work force have been accompanied by an overall decrease in direct service outputs of the city. The information we bring to bear includes (a) city budget documents that show a decrease in service levels, and (b) evidence that there has been a shift in the mix of personnel, with gradually fewer employees in direct service agencies.

Conclusion: Increases in programs and activities do not account for the growth in municipal expenditures, since the city appears to be funding fewer programs and activities.

3. Next we show that inflation accounts for about three-fourths of the growth in municipal expenditures over the five-year period. Comparing the increases in employee wages and benefits in Los Angeles with the "standard" increases included in inflation indexes shows that Los Angeles employee compensation is not out of line with other cities or the private sector.

4. However, over the five-year period some employee job positions were eliminated or reduced in number, while others were introduced

or increased in number. We show that the added positions were more highly paid, and had a faster rate of increase in compensation, than the positions they substituted for. This shift in the mix of employees accounts for most of the remaining increase in the city's expenditures.

5. The residual increase--the part not explained by inflation or the shift in the mix of employees--comprises many diverse items. For example, the state and federal governments have become major sources of municipal government revenues. Most of these funds have been used to support state and federal priority activities within traditional city agencies. However, large amounts are simply transferred to noncity agencies for community development and social service projects. The transfers inflate the recipient government's budget, but they do not reflect costs of providing traditional municipal services, nor do they represent a burden on local taxpayers. The residual increase also includes another phenomenon: Local governments have experienced a rising tide of litigation associated with liability claims and lawsuits charging violations of civil rights and equal opportunity provisions of the Constitution. Continuation of this trend could pose a serious future fiscal problem.

THE CITY OF LOS ANGELES: BUDGETS VS. EXPENDITURES

The City of Los Angeles operating budget is currently about $1 billion, or $350 per capita. Excluded from these figures (and from all those that follow) are the expenditures of three independent city departments (Department of Airports, Harbor Department, and Department of Water and Power), which are required to generate revenue adequate to meet their own expenditures. Also excluded are certain expenditures funded by revenues developed outside the general city budget, primarily for cultural and recreational activities.

The functions performed by the City of Los Angeles are somewhat more limited than those performed by cities in some other states. Most notably absent from the Los Angeles budget are any significant expenditures for health and welfare services (handled by Los Angeles County) and education (handled by school districts).

The budgeting process, similar to that in many cities, produces several different budget documents for each year. In April, the mayor's

proposed budget is submitted to the city council. After the council has revised and approved the budget, the city's *adopted* budget is published. During the course of the fiscal year, various adjustments and modifications may be made, but ordinarily no new complete budget documents for the entire city are prepared. (In 1978, however, the extensive revisions required by the passage of Proposition 13 entailed the publication of more than one adopted budget.) The cumulative effect of these modifications can be observed in the *subsequent* year's budget documents, which show (for comparison purposes) the current year's budget figures. Finally, several months after the close of the fiscal year, the city controller publishes a statement showing *actual* expenditures.

Los Angeles's budget documents are useful for analysis because budget modifications in this city are usually not extensive, and the actual expenditures of most departments, especially operating departments, are fairly close to their adopted budget allocations (see Table 3.1).[2] Overall, actual expenditures exceeded the fiscal year (FY) 1976[3] budget allocation by only 1.2 percent. The excess was much greater, however, for the departments listed at the bottom of the table. As we shall see, these same departments are among the ones that have also had the largest year-to-year budget increases, meaning that their expenditure increases appear to have been unpredictable as well as rapid.

EXPENDITURE TRENDS IN LOS ANGELES

We chose FY 1973 as the base year for measuring budget changes in Los Angeles. This choice allowed a five-year period for examination of expenditure trends prior to the passage of Proposition 13. During this period (FY 1973 to FY 1978), the city budget increased 64.1 percent, from $626.6 million to $1028.0 million, or 10.4 percent per year on the average. Table 3.2 lists the main components of the budget. These figures show that while salaries constitute around half of the city's expenditures, they have not been increasing nearly as fast as some other

[2] For a description of available budget figures and how they were used in the analysis, see Chaiken and Walker, 1979.

[3] FY 1976 ran from July 1, 1975 to June 30, 1976.

Table 3.1

COMPARISON OF ACTUAL WITH BUDGETED EXPENDITURES, CITY OF LOS ANGELES, SELECTED DEPARTMENTS, FY 1976

Department	Budget Allocation ($ million)	Actual Expenditure (% difference)
Animal Regulation	2.9	-4.0
Building and Safety	13.7	4.4
City Administrative Officer	3.3	1.2
City Clerk	5.1	-5.1
Council	4.8	-4.2
Fire	84.9	-2.9
Planning	4.4	-0.7
Police	197.0	-0.7
Public Works		
Engineering	21.8	-0.3
Public Buildings	18.0	2.8
Traffic	11.3	-1.5
City Attorney	9.3	15.0
General City Purposes	5.6	6.4
Mayor	1.7	39.5
Personnel	30.0	19.5
Public Works (Board office)	1.1	30.1

components. The largest percentage increase has occurred in fringe benefits, followed by capital expenditures; the lowest has been for purchase of equipment. As discussed in the next section, the total number of regular city employees was about the same in FY 1978 as in FY 1973; consequently, the increases in salary and benefit expenditures shown in Table 3.2 can be interpreted as roughly reflecting the increases in the average employee's salary and benefits.

Table 3.3 shows the same budgets broken down by department. The amounts listed for each department are the total costs--which include allocations of such centralized functions as personnel administration and data processing--rather than the appropriated amounts that are under the control of the department head. The table shows that the bulk of the dollar increase is accounted for by the largest departments, namely, police, fire, and sanitation. However, the fastest rates of increase

Table 3.2

MAIN COMPONENTS OF THE LOS ANGELES CITY BUDGET

Item	Budgeted Amount[a] ($ million) FY 1972-73	FY 1977-78	Percent Change Over Five Years	Annual Average
Salaries	377.0	547.1	45.1	7.7
Fringe benefits[b]	105.3	223.7	112.4	16.3
Expenses	51.3	85.9	67.4	10.9
Equipment	12.4	14.6	17.7	3.3
Capital improvement	36.3	71.0	95.5	14.3
Other	44.1	85.6	94.1	14.2
Total	626.6	1028.0	64.1	10.4

SOURCE: Adopted budgets.

[a]For two departments (Library and Recreation and Parks), which have revenue in addition to their appropriations, the city's appropriated funds were assumed to have been divided among the six components in the same proportions as the department's total expenditures were divided among these components.

[b]Pension, health insurance, and worker's compensation.

are in much smaller departments that collectively account for only 6 percent of the FY 1978 budget. These rapidly growing departments are:

City Attorney
City Council
Street Lighting
Public Utilities and Transportation
Community Development
City Administrative Officer
Municipal Arts
Controller
Mayor

The undifferentiated category "all other" has also experienced a high rate of increase, exceeded only by two departments.

The following sections examine the growth patterns that underlie these trends in expenditures.

Table 3.3

DEPARTMENTAL COMPONENTS OF LOS ANGELES CITY BUDGET

Department	Total Budgeted Cost[a] ($ million)		Percent Change	
	FY 1972-73	FY 1977-78	Over Five Years	Annual Average
Animal Regulation	3.1	4.8	55.4	9.2
Building and Safety	14.0	20.1	44.1	7.6
City Administrative Officer	2.8	5.3	85.6	13.2
City Attorney	5.8	15.3	163.2	21.4
City Clerk	5.7	8.1	43.2	7.4
Commission on Status of Women	--	0.1	--	--
Community Development	4.8	9.2	90.8	13.8
Controller	2.2	3.9	73.9	11.7
Council	3.7	8.0	117.1	16.8
Employee Relations	0.1	0.1	23.5	4.3
Fire	97.2	150.1	54.4	9.1
Mayor	1.6	2.8	72.7	11.5
Municipal Arts	0.9	1.6	80.4	12.3
Municipal Auditorium	--	6.1	--	--
Off-street Parking	0.1	0.2	49.8	8.4
Personnel	5.6	8.2	45.7	7.8
Planning	4.0	6.3	56.7	9.4
Police	211.7	348.8	64.8	10.5
Public Utilities and Transportation	0.3	0.7	99.9	14.9
Public Works				
Board Office	1.1	1.6	43.6	7.5
Accounting	0.9	1.2	34.5	6.1
Contract Administration	3.7	4.4	17.5	3.3
Engineering	23.5	29.2	24.0	4.4
Personnel	0.7	0.9	15.1	2.8
Public Buildings	7.6	10.6	39.6	6.9
Right of Way and Land	2.5	3.8	51.2	8.6
Sanitation	34.5	54.3	57.4	9.5
Standards	1.3	1.8	41.4	7.2
Street Lighting	7.5	15.3	105.9	15.5
Street Maintenance	40.8	54.2	32.8	5.8
Social Services	0.4	0.5	35.5	6.3
Supplies	1.3	2.0	52.1	8.7
Traffic	12.9	18.4	43.0	7.4
Treasurer	1.0	1.4	44.5	7.6
Subtotal, departmental[b]	505.4	799.0	58.1	9.6

For footnotes, see next page.

Table 3.3--continued

Department	Total Budgeted Cost[a] ($ million) FY 1972-73	FY 1977-78	Percent Change Over Five Years	Annual Average
Library[c]	16.6	23.7	43.3	7.5
Recreation and Parks[c]	27.9	41.6	49.1	8.3
All other[d]	76.7	163.7	113.5	16.4
Total, all departments	626.6	1028.0	64.1	10.4

SOURCE: Adopted Budget.

[a]Total cost includes funds appropriated to some other department but expended on behalf of this department. Two departments (Data Service Bureau and Transportation Department) are not shown because all of their appropriated funds are expended on behalf of other departments. Costs for five departments that existed in FY 1973 but not FY 1978 have been included in the FY 1973 costs of their successor departments.

[b]Includes appropriations for elections, not shown in detail.

[c]Only expenditures from the city's general fund are shown for two departments. These departments also expend their own separate revenues.

[d]Includes capital improvement, community development trust, bond redemption, and interest.

CHANGES IN SERVICE LEVEL

One possible explanation for the rapid growth in local government expenditures is that the government has recently taken on a wide range of new services, or has expanded existing services to meet increased needs. It is difficult to obtain an unambiguous assessment of service level changes in a jurisdiction over time because of the well-known problems of measuring service outcomes in the public sector (Hatry, 1972, pp. 776-784; Mark, 1972, pp. 747-763; Ostrom, 1975). However, we have used two approaches to obtain insights into service level changes, and the results tend to lead to the same conclusion. The first approach examines public employment levels for the evidence they yield concerning service levels. The second takes advantage of the unique presentation

of Los Angeles's program budget, which uses service-level change as one category for explaining changes in budget allocations from one year to the next.

The conclusion that we were able to draw from both analyses is that increases in service levels could not possibly explain the increase in expenditures, and in fact that service levels in many Los Angeles operating agencies have been decreasing.

Evidence from Public Employment Figures

All things being equal, increasing employment can be expected to translate into improved or expanded service. Table 3.4 shows that although municipal government employment increased considerably between 1962 and 1972, it has shown practically no growth since 1973. A shrinking municipal work force seems to be the recent trend in many cities. For example, in 1976 half of the 20 largest cities in the United States reportedly reduced the number of employees on their payrolls (Bahl et al., 1978).

In Los Angeles, the number of regular city employees remained virtually constant between FY 1973 and FY 1978, and declined 1.5 percent between FY 1975 and FY 1978 (see Fig. 3.1). But, it is the aggregate of all employees who contribute to the output of municipal services. In Los Angeles, as elsewhere, workers supported by federal funds

Table 3.4

GROWTH IN STATE AND MUNICIPAL GOVERNMENT EMPLOYMENT, 1962-1976

	Average Annual Percentage Growth	
Period	State	Municipal
1962-1972	5.3	3.2
1972-1973	2.4	3.9
1973-1974	4.2	0.9
1974-1975	3.4	0.7
1975-1976	2.0	-1.7

SOURCE: U.S. Bureau of the Census, *Public Employment in 1976*, Table 2.

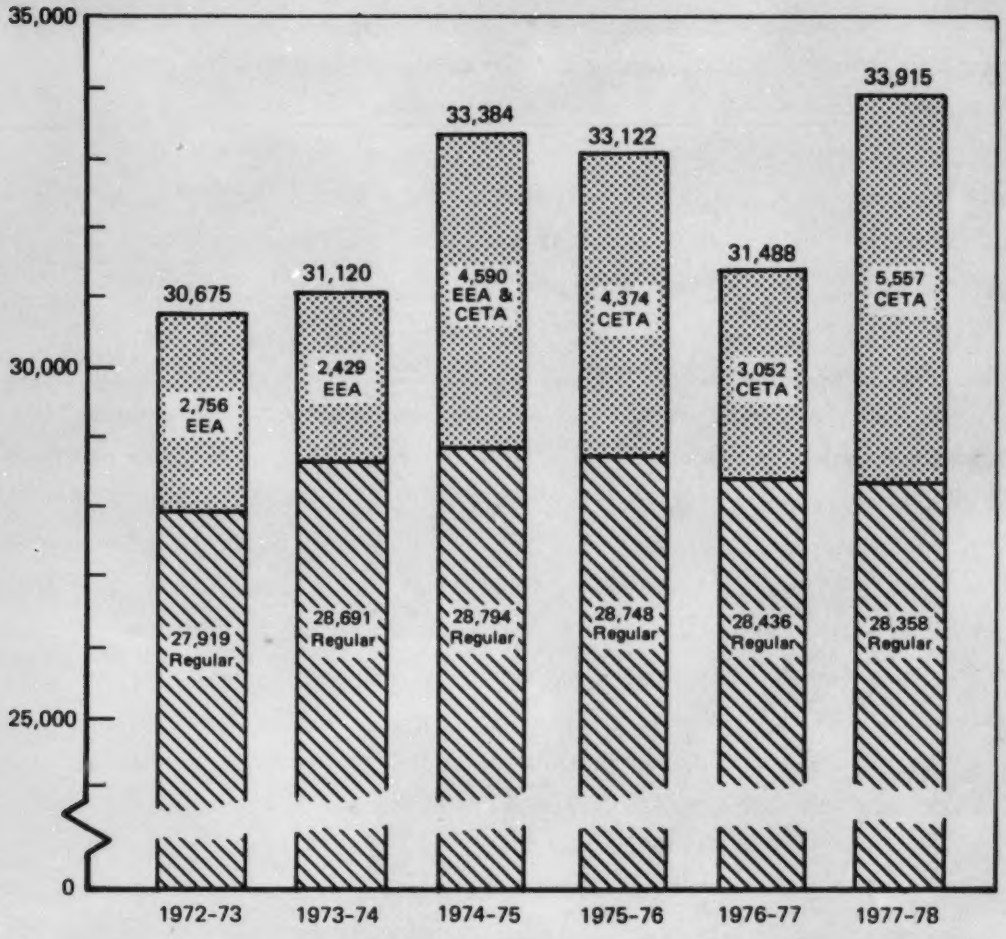

Fig. 3.1 — Regular and CETA employees in Los Angeles (authorized full-time positions)

constitute a growing share of the city work force. The number of employees hired under the Comprehensive Employment and Training Act of 1973 (CETA) and its predecessor program, the Emergency Employment Act of 1971 (EEA), more than doubled over this period. (Figure 3.1 shows the number of positions authorized. Although authorized CETA positions were not all filled, the general trends in CETA employment were as indicated.) These workers were counted as city employees and received paychecks from the city, but the federal government provided the funds for their salaries up to $10,000 per employee. (The city paid any

amount over $10,000. In FY 1978, the city paid $9.2 million in salary costs for 4656 CETA employees, or an average of $1,977 per employee. The 4656 figure is an estimate of the average number of filled positions during the year. See City of Los Angeles, 1978.)

Because in Los Angeles the federal contribution to the salaries of CETA employees is not counted in city revenues or expenditures, the growth of the CETA program accounts for little if any of the increase in city expenditures between FY 1973 and FY 1978. Indeed, if the EEA and CETA employees are ignored altogether, one still must explain an increase of over 63 percent in expenditures over the five-year period. The change in the number of regular employees during this period would (by itself) explain about 1.5 percentage points of this increase, which in turn suggests that service-level changes have not strongly influenced total budgeted expenditures.

Shift in Activities

An examination of employment figures by department, however, reveals some significant shifts in agency activities during recent years. *In particular, there have been shifts away from the universalistic agencies that provide direct services to the general public, and toward agencies that provide support to other government functions or to special groups.*

Table 3.5 compares the numbers of agency employees in FY 1978 with those in FY 1973 and FY 1975. The figures show that the agencies providing traditional city services (e.g., fire, police, and public works, which includes sanitation) have had small increases in employees at best, and some have experienced decreases since 1975. At the same time, the departments that have substantially expanded since 1973 include most of the overhead departments, e.g., City Council, City Clerk, Mayor, City Attorney, Treasurer, and Controller. (The city's program budget includes a program entitled "general administration and support." Departments were classified as "overhead" if more than half of their expenditures were in this program area.)

The remaining departments with large consistent increases--Arts, Community Development, Municipal Auditorium--serve more targeted constituencies than do the traditional services. There are some necessary qualifications to these general observations; for example, the Recreation

Table 3.5

DEPARTMENTAL EMPLOYMENT TRENDS IN LOS ANGELES

Department	Full-time Authorized Employees, FY 1978			Percent Change in Total	
	Regular	CETA[a]	Total	Since FY 1973	Since FY 1975
Overhead[b]	2,497	904	3,401	35.3	5.4
Controller	115	15	130	36.8	26.2
City Attorney[c]	449	89	538	69.2	25.7
City Clerk	337	87	424	16.2	14.9
City Council	192	294	486	120.9	13.3
Treasurer	53	0	53	10.4	6.0
Public Utils. and Transp.	338	6	344	2.7	3.3
City Admin. Officer	143	4	147	9.7	0.0
Data Service	371	59	430	0.2	-1.6
Mayor	67	69	136	78.9	-4.2
Personnel	340	249	589	46.5	-8.8
Supplies	92	32	124	34.8	-13.9
Service	25,861	4,653	30,514	8.4	1.2
Municipal Arts	43	54	97	169.4	155.3
Community Development	351	48	399	48.3	79.7
Municipal Auditorium	92	35	127	74.0	27.0
Recreation and Parks	1,921	2,213	4,134	54.3	24.5
Library	1,089	321	1,410	12.6	5.6
Building and Safety	773	101	874	7.8	2.9
Traffic	558	151	709	14.0	1.4
Fire	3,550	6	3,556	2.0	0.1
Police	10,296	269	10,565	4.3	-1.1
Animal Regulation	187	95	282	8.5	-4.4
Planning	216	27	243	7.5	-5.4
Public Works	6,755	1,331	8,086	-1.5	-7.2
Social Service	17	--	17	-74.6	-76.1
Other	13	2	15	-48.2	0
Total	28,358	5,557	33,915	10.6	1.6

SOURCE: *Detail of Positions and Salaries*, Adopted Budgets, City of Los Angeles.

[a]Although not all CETA positions were filled, the authorized numbers correctly reflect their patterns of allocation.

[b]Departments are listed as "overhead" if they have more than half of their expenditures in the program "general administration and support," according to the city's budget.

[c]Although more than half of this department's budget is for administrative and support functions, it also performs many service functions.

and Parks Department increase was largely due to an infusion of CETA personnel. (In addition, the Bureau of Street Maintenance, which is part of Public Works and not shown separately in Table 3.5, received about one-quarter of the city's CETA employees.) Also, some overhead agencies (e.g., Planning and Supplies) have not shown sustained employment increases. But the overall pattern is the shift of personnel toward overhead agencies.

That shift is not necessarily evidence of increased "fat" or decreased productivity in government, for the overhead agencies provide some services of their own to the public and presumably increase the efficiency of other agencies. Much of the increase in the size of these agencies may be attributed to a movement toward the corporate model of "good government" (more sophisticated budgeting, staff activities, and managerial functions), and some to an increase in the burden of federal and state mandates (including new regulations and reporting requirements).

The increase in the Community Development Department is directly related to the sharp increase during this period in federal and state funding of local government activities.[3] Almost all of the expenditures of the department are reimbursed by grants; its programs include training CETA employees, providing services for the aged, and supporting the revitalization of commercial areas.

Evidence from Budget Analyses

Information in the city's budgets confirms both a shift in the mix of services provided by the city and a general decrease in the overall level of direct service outputs. First, the budget documents include a table that shows how total expenditures are allocated among six functional categories. One of these categories is called "general administration and support." As shown in Table 3.6, expenditures in this category increased from 8.1 percent of the budget in FY 1973 to 10.1

[3]Federal and state subventions and grants, which contributed only $108 million in revenues to the city in FY 1973, contributed $216 million in revenues in FY 1978. Only a small portion of community development grants appear in the expenditure budget of the Community Development Department; the bulk are passed through a trust fund to contractors and other ultimate recipients of the grants.

Table 3.6

FUNCTIONAL CATEGORIES OF EXPENDITURES,
CITY OF LOS ANGELES

Function	FY 1973 Budget		FY 1978 Budget		
	$ Million	% of Total	$ Million	% of Total	% Increase Over FY 1973
Community safety	312.6	49.9	494.7	48.1	58.2
Home and community environment	101.5	16.2	190.0	18.5	87.2
Transportation	100.9	16.1	141.6	13.8	40.4
Cultural, educational, and recreational services	54.9	8.8	82.8	8.1	50.6
Human resources, economic assistance and development	5.9	0.9	14.8	1.4	150.6
General administration and support	50.8	8.1	104.3	10.1	105.4

SOURCE: Adopted Budgets, Exhibit "E", City of Los Angeles.

percent in FY 1978, while expenditures on community safety, transportation, and cultural, educational, and recreational services all declined as a percentage of the total budget.

Even though this shows a substantial relative increase in expenditures for overhead functions, the method used by the city's budget analysts in assigning expenditures to this category omits large amounts of expenditures on overhead activities. In particular, expenditures on internal management activities within a department are excluded from the "general administration and support" category. For example, expenditures on internal management and support functions within the Police Department are included on the "community safety" line in Table 3.6.

To draw a more complete portrait of overhead expenditures, we combined expenditures for internal management and technical support services

with the other expenditures on general administration and support. The result was that total expenditures for overhead amounted to $151.0 million in FY 1973 (24.1 percent of the budget) in contrast to $298.8 million in FY 1978 (29.1 percent of the budget)--more than a 20-percent increase in overhead expenditures as a proportion of the budget.

The special structure of Los Angeles's program budget (*Detail of Department Programs*) also facilitates the analysis of service-level changes, if the data are treated with sufficient care. This budget assigns all changes in positions and costs between two fiscal years to one of five categories. Here we are interested in the categories "service level changes," "workload changes," and "new facilities."

Although the Los Angeles city budget was over $400 million higher in FY 1978 than in FY 1973, net service-level changes and workload changes (including the contributions of CETA workers) were generally negative over this period, and new-facility costs were relatively small. The sum of service level, workload, and new-facilities changes in the budgets from FY 1974 through FY 1978 show a net decrease of $23.6 million (see Table 3.7), which is a small amount compared with the total budget, but supports our conclusion that service-level increases do not explain the expansion of the city's budget over the last few years. In fact, these results suggest that the city would have to increase the budget by several million dollars if it wanted to deliver the same services that it was delivering in 1973. (For details of the budget analysis performed, see Chaiken and Walker, 1979.)

INFLATION

Indexes of Inflation and Price Increases

Inflation affects government expenditures *directly* by increasing prices paid for materials and services (such as labor) that governments purchase, and *indirectly* by forcing salaries and benefits upward to keep pace with the cost of living. In principle, it is not difficult to determine the direct inflationary share of municipal budget increases, since accurate price indexes are published for most categories of goods and services by the Department of Labor's Bureau of Labor

Table 3.7

BUDGET CHANGES REFLECTING CHANGES IN WORKLOAD, SERVICE LEVELS, AND FACILITIES IN LOS ANGELES

Fiscal Year	Change from Previous Year ($ million)		
	Service Level Increases	Workload Increases	New Facilities
1974	-26.2	3.5	1.2
1975	- 3.3	-2.5	2.7
1976	4.3	-2.8	2.1
1977	- 2.3	0.1	0.3
1978	- 2.8	0.3	1.8
Total	-30.3	-1.4	8.1

SOURCE: *Detail of Department Programs*, City of Los Angeles proposed budgets.

Statistics. Even conceptually, however, it is somewhat difficult to state how inflation of salaries and benefits should be calculated. Researchers have used two basic approaches to the problem, yielding results that are quantitatively distinct, although qualitatively both approaches confirm that inflation explains a substantial fraction of municipal expenditure increases.

The first approach is based on estimates of cost of living increases for comparable occupational categories such as executives, laborers, etc., in a particular region, and results in an *inflation index* (Greytak, Gustely, and Dinkelmeyer, 1974; Greytak and Jump, 1977). The second approach uses data on salaries and benefits actually paid to employees by municipal governments in the United States and results in a *price index* (Walzer, 1970; Walzer and Stratton, 1977; Goldman and Strong, 1978). The inflation index shows what would have happened to costs if employees' compensation had been adjusted so as to maintain real income, while the price index reveals the change in expenditures necessary to maintain a base level of labor inputs (but does not distinguish between the effects of inflation and increases in real compensation).

The Effect of Inflation on Municipal Compensation

Table 3.8 shows the results of using the first approach (inflation index) for nearly all municipal governments in the United States. (The inflation index was calculated using data from the U.S. Census of Governments.) The general picture is that during the five-year period preceding 1972, inflation of municipal government expenditures lagged slightly behind inflation experienced by consumers; then, in a two-year period of rapid inflation, municipal governments suffered larger effects than did consumers; more recently, the previous pattern was reestablished as inflation declined but remained above the pre-1972 level. Overall, then, according to these results, inflation alone would have produced a 40.6-percent increase in the expenditures of municipal government between 1972 and 1976. During this period the Los Angeles budget increased 56.3 percent; consequently, assuming that Los Angeles does not differ substantially from other cities, the implication is that roughly 72 percent of the increase can be accounted for by inflation.

Table 3.9 shows the municipal price indexes (MPIs) that result from applying the appropriate price indexes to each category of expenditures in Los Angeles.[4] Overall, the table shows that over the five-year period under study here, price increases alone would have forced the budget to increase 48.2 percent or by $302.1 million. The total budget increase was actually 64.1 percent or $401.4 million (as shown previously in Table 3.2); thus, price increases as estimated by this MPI account for 75 percent of the budget increase.

Because the MPIs were based on labor costs in all California cities, not merely Los Angeles, the question arises whether employee compensation (exclusive of accumulated but unfunded pension liabilities)[5]

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[4]See Chaiken and Walker, 1979, for additional detail on the calculation of the Municipal Price Index.

[5]The officially recognized unfunded liabilities for Los Angeles's two pension systems are $2.0 billion for fire and police and $661 million for other city employees. The true unfunded liability is undoubtedly higher, as these estimates are calculated assuming inflation rates of 3.5 percent per year and salary increases averaging 3 percent per year.

Table 3.8

INFLATION INDEX FOR MUNICIPALITIES

Index	Average Annual Percentage Increase 1967-72	1972-74	1974-76
Municipal Expenditure Index	4.2	12.0	5.9
Consumer Price Index	4.6	8.6	7.4

SOURCE: Change in municipal expenditures calculated from Table 6 in David Greytak, "The Increasing Costs of Local Governments: Underlying Causes and Policy Considerations," reprinted in *Local Distress, State Surpluses, Proposition 13: Prelude to Fiscal Crisis or New Opportunities?*, Hearings Before the Subcommittee on the City, Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, July 25, 1978, pp. 143-173.

Table 3.9

MUNICIPAL PRICE INDEXES, CITY OF LOS ANGELES

Function	Average Annual Percentage Increase 1972-74	1974-77	Overall Percent Change, 1972-77
Police	8.1	7.8	46.5
Fire	10.1	9.2	57.7
Parks and Recreation	7.7	8.5	48.3
Public Works	9.0	7.3	46.9
General Government	8.5	8.1	48.6
Other	8.2	7.6	46.0
Municipal Price Index (all services)	8.6	7.9	48.2
Consumer Price Index			
National	8.6	7.1	44.8
Los Angeles area	7.9	8.0	46.8

increased faster in Los Angeles than in other cities. Our calculations suggested that the increases in employee salaries and benefits were almost identical with the increases in the corresponding labor price indexes (LPIs) from other California cities. Despite the close correspondence between labor price increases in Los Angeles and the other cities, we found, as shown in Table 3.10, that in Los Angeles the ratio of total employee compensation to total number of employees showed a faster increase than the corresponding labor price index (with the exception of the Fire Department).

The Effects of a Shift in Composition of Positions

The explanation for an increase in compensation per employee above and beyond the increase in the LPI rests on the previously noted shift in the mix of employees from direct service functions to administrative and support functions. On the average, newly hired employees performing administrative and support functions are paid more than the employees they replace who performed direct service functions.

To demonstrate the extent of this "upward float" in the job positions held by Los Angeles city employees, we classified employees into the pay-rank categories shown in Table 3.11. The separation between a pair of ranks was defined in terms of a job description rather than in terms of a particular salary, so that employees who remained in the same job from FY 1973 to FY 1978 would not change rankings even though their compensation increased. By examining the change in the number of employees in each ranking in Table 3.11, we draw the following conclusions:

- The number of employees with the job position Police Officer II or Firefighter II decreased between FY 1973 and FY 1978. These are the entry-level positions in the uniformed services and constitute the primary field personnel. A decrease in their numbers is consistent with the shift away from direct service functions that we have described earlier.
- The other two rankings that experienced a decrease in the number of employees are the two lowest-paid rankings.

Table 3.10

INCREASE IN EMPLOYEE COMPENSATION, CITY OF LOS ANGELES

Function	Salaries and Benefits per Employee (in $) FY 1973	FY 1978	Ratio for Los Angeles	Comparison Labor Price Index for California Cities[a]
Police	19,832	31,055	1.566	1.469
Fire	25,274	38,222	1.512	1.583
Parks and Recreation	11,435	16,977	1.485	1.475
Public Works	13,925	21,395	1.536	1.443
General Government	14,500	24,465	1.687	1.502
Other	14,482	21,950	1.516	1.451

SOURCE: Calculated from tabulations of salaries, pensions, health benefits, dental benefits, and worker's compensation for regular full-time employees, as shown in Adopted Budgets.

[a]From input data for the computer program used by George Goldman and David Strong, *California Municipal Price Index*, Division of Agricultural Sciences, University of California at Berkeley, 1978.

- Aside from Police Officer II and Firefighter II (our Rank 4), all the middle-paid and high-paid rankings increased in number and as a percentage of the total work force.

Thus there has been a gradual "upward float" of employees to the higher pay ranks. This has caused the city's expenditures on employee compensation to increase faster than inflation, not only because employees in the higher ranks have higher salaries, but also because their benefits have increased faster. The change in benefits is shown in Table 3.12, which reveals that while benefits for uniformed employees have been and still are higher than for civilian employees of the city, the rate of increase in benefits for uniformed employees has recently been much slower than for civilians. It may also have been the case that benefit levels have risen across the board in departments such as Parks and Recreation where they were traditionally low. Perhaps the generous benefit packages won by the uniformed services in years before 1972 stimulated a chain reaction.

Table 3.11

PAY RANKINGS ASSIGNED TO LOS ANGELES CITY EMPLOYEES

Rank	Employees in Rank	Approximate Highest Salary[a] ($/year)		% Increase in Salary from FY 73 to FY 78[b]	Number of Employees[c]			Percent of All Employees[d]		
		FY 73	FY 78		FY 73	FY 78	Change FY 73-FY 78	FY 73	FY 78	% Change FY 73-FY 78
1	Same salary as clerk typist, or lower	7,700	10,380	34	2,549	2,536	-13	8.9	8.8	-0.8
2	Higher salary than clerk typist, lower than sanitation maintenance laborer	9,320	12,600	35	2,829	2,317	-512	9.9	8.1	-18.3
3	Salaries from sanitation maintenance laborer up to, but not including, police officer[e]	14,000	20,300	45	8,099	8,528	429	28.3	29.7	+5.0
4	Police officer, firefighter	14,000	20,300	45	4,884	4,784	-100	17.1	16.7	-2.3
5	Salary higher than police officer, up to police sergeant	18,300	26,770	46	7,867	8,057	190	27.5	28.1	+2.1
6	All salaries higher than police sergeant				2,130	2,313	183	7.5	8.1	+8.3

[a] Employees were assigned to rankings according to their job description. The highest pay for a given job description could be higher than the lowest pay in the next ranking.

[b] The percent increase in total compensation is higher than the percent increase in salaries.

[c] Figures do not add to the same totals as shown in Fig. 3.1 and Table 3.5 because some part-time employees are included here. However, no seasonal workers are counted in this table.

[d] Percentages do not add to 100 because some employees (including commissioners) could not be ranked.

[e] The official names of grades used in separating uniformed employees are Police Officer II, Firefighter II, and Police Sergeant II.

Table 3.12

EXPENDITURES FOR EMPLOYEE BENEFITS IN LOS ANGELES

Function	Benefits as a Percent of Salaries FY 1973	FY 1978	Percent Change, FY 73 to FY 78
Police	42.9	49.8	16
Uniformed only	49.7	56.6	14
Fire	42.7	45.8	7
Uniformed only	45.2	48.4	7
Parks and Recreation	10.7	26.6	149
Public Works	11.0	25.6	133
General Government	9.5	22.4	136
Other	10.0	24.0	140
All employees	27.9	40.9	47

SOURCE: Tabulations of expenditures by department for salaries, pensions, health and dental benefits, and worker's compensation, Adopted Budgets, City of Los Angeles.

Summary: Employee Compensation in Los Angeles

We can summarize our findings concerning employee compensation in Los Angeles as follows. The total increase in expenditures between FY 1973 and FY 1978 was 59.8 percent: $288.5 million on a base of $482.3 million (the sum of the figures for salaries and for benefits in Table 3.2). Of this, we estimate that inflation accounts for $231.9 million, or 80 percent of the total increase. This means that expenditures on salaries and benefits would have increased by $231.9 million if all employees in 1973 had remained in the same job positions and their compensation had increased at the same rate as similar employees in other California cities. In addition, a shift in the mix of employees accounts for $44.7 million, or 16 percent of the total increase. This shift was from low-paid, direct service employees to higher-paid administrative and support employees. The remaining $11.9 million, or 4 percent of the total increase in employee compensation, is explained by an increase in the total number of employees.[6]

[6]Previously (p. 39), we stated that the increase in employees (by itself) accounts for 1.5 percent of $626.6 million, or $9.4

OTHER COMPONENTS OF BUDGET INCREASES

After accounting for the growth in employee compensation between FY 1973 and FY 1978, there remains an increase in expenditures of $112.9 million, of which $70.2 million (or 62 percent) is due to inflation. (The figure of $112.9 million was calculated from the five-year change in the noncompensation expenditures in Table 3.2; the $70.2 million due to inflation was computed by subtracting from the total inflationary increase of $302.1 million, as detailed on p. 45, the $231.9 million of inflation in compensation, as shown in p. 50.) This leaves $42.7 million to explain, which is 11 percent of the total increase. We believe the main explanations for this residual increase are:

- Increases in "transfers" (budget items that do not represent expenditures for government services), and
- Quantity changes (as opposed to price changes) in nonlabor inputs.

"Transfer" Expenditures

The most important type of transfer results from federal grants to the city. As already pointed out, federal and state subventions and grants to Los Angeles almost doubled between FY 1973 and FY 1978. A major source of federal money to the city comes in the form of block grants under Title I of the Housing and Community Development (HCD) Act of 1974. Only a small part of this money is used to fund activities in city departments, and another portion supports capital improvements; but most of the money (approximately 75 percent) is passed into a trust fund. This fund then supports a wide range of projects, most of which are carried out by private, nonprofit organizations. The FY 1978 budget included a transfer of $36.6 million to the fund, which supported over 150 such projects. Although in FY 1973 the city received some similar categorical grants, practically all of the money transferred to the Community Development Trust Fund in 1978 represents an increase over FY 1973.

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million. The difference between $9.4 million and $11.9 million is explained by the effect of inflation on the compensation for the added employees.

Many California cities, including Los Angeles, have municipally owned enterprises, such as water utilities and airports, which generally have their own sources of revenue. But contributions by cities to enterprise agencies have increased considerably in recent years. The increase in Los Angeles for this type of transfer between FY 1973 and FY 1978 amounted to $5.9 million.

Quantities of Nonlabor Inputs

In general, the information presented in readily available budget documents does not permit determination of the expenditure increase for individual types of material inputs. However, we have been able to identify some components that can be compared directly with price indexes that we used in constructing the MPI for Los Angeles. For those inputs it is possible to estimate the part of the increase that exceeds inflation.

Table 3.13 shows that 60 percent of the increase in expenditures on petroleum products, uniforms, and capital improvements cannot be explained by inflation. These noninflationary increases themselves account for $23.7 million out of the $42.7 million of so far unexplained expenditures. In principle, these increases can be divided between (1) increases in quantities of goods and services purchased, (2) payment of higher prices than those reflected in the price indexes, and (3) improvements in the quality of inputs. In practice, we are unable to make this division, but there is no a priori reason to believe that quality would have improved or that city purchasing practices would have deteriorated over this time period. The most likely answer lies in quantity increases.

The remainder of the budget changes between FY 1973 and FY 1978 consist of fairly numerous small increases and decreases. One of the largest decreases in Los Angeles is in expenditures for bond redemption and interest payments, which dropped from $26.3 million in FY 1973 to $19.1 million in FY 1978. (The city prides itself on maintaining a low bonded indebtedness. Between FY 1964 and FY 1978, its per capita debt decreased from $84.77 to $42.86.)

Table 3.13

GROWTH IN EXPENDITURES ON PETROLEUM PRODUCTS, UNIFORMS, AND CAPITAL IMPROVEMENTS IN LOS ANGELES

(In $ million)

Expenditure Item	FY 1973	FY 1978	Index[a]	Component of Increase	
				Inflation	Remainder
Petroleum products[b]	3.0	7.5	146.5	1.4	3.1
Uniforms[b]	0.2	0.7	121.9	0.1	0.4
Capital improvements					
Streets[c]	23.3	44.9	124.0	5.6	16.0
Structures[c]	13.0	26.1	168.7	8.9	4.2
Total	39.5	79.2		16.0	23.7

[a] 1973 = 100.

[b] Source; *Annual Reports, Los Angeles City Controller,* 1973 and 1978.

[c] Source: Adopted Budgets, City of Los Angeles.

One of the most important of the increases, in terms of its implications for local government in the post-Proposition 13 world, is the increase in costs associated with litigation of civil suits brought against the city. Between FY 1973 and FY 1978, the city's litigation expense almost doubled--from about $2.5 to about $5 million annually--and the cost of claims settlements was nearly three times higher in FY 1977 than in FY 1973 (the city carries no liability insurance).

The primary factor behind these increases--which has been characteristic of cities throughout California--is that immunities formerly enjoyed by governmental entities have recently been eroded by judicial interpretations and state and federal legislation. As a result, there has been a sharp increase in the number of claims against government entities (many of which are without foundation, but require governments to devote resources to their defense) and in settlement costs.

Government liability is only one area in which lawsuits are increasingly being brought against public entities. They are being named in suits charging violations of Equal Employment Opportunity and civil

rights laws. The settlements tend to be costly (back wages, retroactive promotions, etc.). In addition, there have been increases in suits brought against police officers charging false arrest, illegal entry, and civil rights violations. All of these have contributed to the increased cost of government in the past few years, and may become more worrisome in the post-Proposition 13 world as employment opportunities--and, perhaps, the quality of the work force--diminish. Even such apparently unrelated items as decreased expenditures for maintenance can increase the liability exposure of cities if they lead to increased injuries or unsafe conditions.

CONCLUSIONS

Table 3.14 summarizes the causes of increases in the Los Angeles city budget. Inflation (in compensation and other expenditures together) accounts for three-quarters of the increase, and "upward float" in employee compensation another 11 percent. We determined that, during the five-year study period, there has been a gradual shift in the mix of city employees in Los Angeles, with a decrease in the number of regular employees in direct service functions and an increase in the number in support and administrative functions. This shift is evidenced not only by a relative increase in size and budget of overhead agencies as compared with direct service agencies, but also by a reorientation of expenditures within agencies toward the administrative functions. This shift further increased the cost of government because the added personnel in support functions have higher salaries and faster rates of increase in benefits than did the direct service personnel they replaced.

These events have occurred during a period when property taxes paid to the city were rising at an annual rate higher than the yearly increase in consumer prices. That the Los Angeles electorate should have voted for Prop. 13 seems unremarkable in the light of these facts, although most voters were certainly unaware of the precise details. The residents of other cities in California may have experienced similar declines in the benefit/cost ratio for municipal services. The landslide for Prop. 13 throughout most of the state is consistent with such an interpretation.

Table 3.14

COMPONENTS OF INCREASE IN THE LOS ANGELES CITY BUDGET, FY 1973 TO FY 1978

Item	Change ($ million)	% of Increase
Employee compensation		
Inflation	231.9	57.8
Shift in mix of employees	44.7	11.1
More employees	11.9	3.0
Other		
Inflation	70.2	17.5
Residual	42.7	10.6
Total	401.4	100.0

Our examination of the growth in expenditures in Los Angeles over the five-year period did not reveal any simple means to achieve greater economy in Los Angeles City government. Rather, it highlighted the difficulties of achieving any substantial cutbacks without sharp reductions in nominal service levels.

One fundamental observation we made is that although Los Angeles City expenditures have increased at a rate of more than 10 percent a year in the recent past, the services paid for by local taxpayers have not been increasing. Only federally funded programs such as CETA have registered sharp increases in service levels in recent years. Elimination of recently added activities therefore would not reduce the burden on local taxpayers. To reduce the demand on local revenue by cutting back on activities will require cuts in traditional city functions. Reducing the compensation of municipal employees provides no easy remedy. As Chaiken and Walker (1979) have shown, employee wages and fringes in recent years have merely paralleled increases in the cost of living. Cutting compensation would thus reduce the real incomes of city workers.[7]

[7] In this analysis we did not examine the city's unfunded liability for employee retirement. It is possible that employee benefits have increased substantially without being reflected in budget expenditures. If true, reductions in compensation may not be so inequitable; but pension obligations do have serious implications for the future, particularly during times of fiscal containment. In order to fund the benefits,

The implications of "upward float" for future cost-cutting efforts are not completely clear. Some of the added administrative functions are intended to increase the efficiency of the direct service functions. To the extent that they are successful, the administrative functions cannot be eliminated without deleterious consequences. Other administrative and support functions have been added in response to changes in society and to mandates in state and federal legislation and regulations. This situation raises a possible paradox for the future: The very functions that the public wishes to eliminate may remain, while the most desired services decrease in quantity and quality.

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city administrators would have to increase current expenditures for those future years. Moreover, if lessened prospects for future job advancement cause more employees to retire than were anticipated in actuarial projections, the city will be hard pressed to find the funds to cover the added retirement costs.

Chapter 4
THE FISCAL LIMITATION MOVEMENT

The foregoing chapters have discussed trends in state and local fiscal matters, and have offered various explanations of *why* the period of growth in local government may be nearing an end. We next turn to the question of *how* that growth has been dampened.

This chapter analyzes and classifies formal fiscal limitation measures, providing a historical perspective on the preconditions and consequences of their adoption.

Recent years have seen a trend toward restricting government expenditures or revenues by means of statutory or constitutional fiscal limits. The most radical of these actions was California's Proposition 13, approved by the voters on June 6, 1978. This event raised the spectre of a citizens' revolt against taxes, and the national media responded with predictions that Prop. 13 fever would sweep across the country.

Subsequent events suggested that these predictions were exaggerated; of the four November 1978 ballot measures that were modeled on Prop. 13, two passed and two were defeated. Nevertheless, the fiscal limitation "movement" lives on. Several restrictive measures received voter approval in November; more are being readied for consideration by state legislators or the electorate; balanced budget and expenditure cap bills have been introduced in Congress and even proposed as amendments to the U.S. Constitution.

This chapter fleshes out our picture of trends in fiscal limitation at the state and local level. It surveys limitations that constrain general local and state government but does not review controls that apply only to the fiscal powers of school districts. All too often, assessments of the likely future enactment of fiscal limits and their effects rest on simplistic assumptions that regard different measures as alike and ignore links with past fiscal restrictions. Accordingly, this chapter addresses three questions:

- o What are the major approaches to formal fiscal limitation today?
- o Is the current surge of fiscal limitation measures unique?
- o How do current fiscal limitation efforts differ, if at all, from previous measures?

MAJOR APPROACHES TO FISCAL LIMITATION

Current fiscal limitation efforts fall into two broad classes: (1) those aimed at *cutting back existing levels* of government expenditures and taxation; and (2) those aimed at *restricting the future growth* of government. The approaches differ in their goals and in the variety and flexibility of measures they would enact.

The "cutback" approach, exemplified by Prop. 13, aims at providing immediate tax relief and reducing government expenditure. It asserts that the tax burden is too heavy and that government is huge, wasteful, and expensive.

The "growth limits" approach aims at limiting future growth through lids on spending or taxing, but does not seek to reduce existing government expenditures or to provide immediate tax relief. It asserts that, although current levels of government expenditures are not out of line with the private sector, restrictions are needed to ensure that the public sector will not outgrow the private economy.

Cutback Measures

The archetype for the cutback approach is California's Prop. 13, which contains five major provisions:

- o It rolls back the full cash value of each property to the estimated 1975-1976 market value (or the value of the property at its last sale after 1975).
- o It restricts increases in a property's cash value for tax-assessment purposes to a maximum of two percent per year. When it is sold, or undergoes major alteration, the property can then be revalued according to its actual market price.
- o It limits property taxes to one percent of a property's full cash value (taxes for paying off indebtedness incurred before

June 6, 1978 constitute the one exception to the one percent limit).

- o It requires a two-thirds vote of the qualified electors to enact new local taxes (or to increase nonproperty taxes at the local level).
- o It requires a two-thirds vote of both houses of the legislature to increase state taxes.

The effect of Prop. 13 was to reduce annual property tax collections by approximately $7 billion from the prevailing level. It gave immediate tax relief to current homeowners, but did not speak to the problem of renters. Since property tax assessments are rising in California as a result of a higher than anticipated turnover of property (at which point reassessments are permitted), the long-term effects of Prop. 13 may entail a slowing in tax growth trends rather than a permanent tax reduction.

As of this writing, only California and Idaho have enacted this type of fiscal limit. In November 1978, the Nevada electorate approved a proposal that reproduces all of the features of Prop. 13, but Nevada law requires voter approval in two successive elections. The Idaho limit reproduces all of Prop. 13's features except the rollback of full cash value to 1975 levels.[1] All three state limits therefore apply to only one form of taxation and one level of government. All three also work to reduce local property tax collections from existing levels, severely restrict the authority of elected officials to raise other revenues, and selectively benefit different taxpayer groups.

Growth-Limit Measures

Unlike the "cutback" approach, the growth-limits approach has several prototypes. Some limit expenditures while others limit revenues; some restrict local government action, and others limit state action; some apply to all expenditures or revenues, and others apply only to specific taxes.

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[1] However, the 1 percent tax rate is a clear reduction from Idaho's current average of 1.7 percent. See "Tax Revolt Heads for Fall Ballots," *State Government News*, July 1978, pp. 6-8.

In New Jersey, fiscal limits focus on spending and apply to both state and local government units. New Jersey's 1976 law limits the growth of state expenditures to the percentage increase in per capita personal income from one year to the next; it also prohibits counties and municipalities from increasing their final appropriations by more than 5 percent over the previous year without voter approval (ACIR, February 1977).

Similar state expenditure controls exist in Arizona, Colorado, Hawaii, Tenessee, and Texas; they differ mainly in whether the lid is expressed as a fixed or variable limit. Colorado limits state spending increases to a flat 7 percent per year; Hawaii, Tennessee, and Texas limit state spending increases to growth in the state economy; and Arizona limits state spending increases to 7 percent of personal income in the state.

On the revenue side, growth limits typically apply to local rather than to state governments, and they have a specific focus (e.g., on the property tax).[2] Unlike earlier limits on property tax rates, most of the local limits passed since 1970 curb property tax levies (or the total amount of revenues collected from property taxes). Two variants predominate: (1) limits on the annual growth of property tax levies; and (2) full disclosure or "truth in taxation" laws (which prevent property tax collections from exceeding the previous year's without public hearings and open vote by the local governing body). An example of the former is Minnesota's 1971 law limiting jurisdictions with population over 2500 to a 6-percent annual increase in their per capita property tax levy. An example of the latter is Florida's full disclosure law, which requires the establishment of a property tax rate that will produce revenue equal to the preceding year's property tax collections. This rate can be exceeded only after a public notification, hearing procedure, and explicit vote of the local governing council.

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[2]One exception is Michigan's new amendment tying the growth in state revenues to increases in state personal income. Another specific growth limit measure is income tax indexing, which essentially prevents people from being pushed into higher tax brackets without taking inflation into account. Colorado instituted such indexing in 1978 and California in October 1979; Arizona has passed a partial income tax indexing law.

that when the tax base exceeds that of the preceding year, the operative property tax rate has to be lowered.)

Comparison of Growth-Limit and Cutback Approaches

In comparing the approaches to fiscal limitation, it is useful to note differences in ideology and pragmatic orientation. The growth-limits approach is marked by ideological as well as strategic diversity. In contrast, the cutback approach reflects a more specific and non-philosophical approach to fiscal control.

Many organized groups that promote fiscal lids base their actions on a specific criticism of how our democratic system of government works. They believe the system has built-in incentives for more and more government spending. (They contend, for example, that elected officials bend too readily under interest-group pressures to expand government programs.) To remove those incentives, the only recourse is citizen action, preferably approval of a permanent control on taxes or expenditures in the form of a constitutional amendment (Rickenbacker and Uhler, 1977).

This philosophy is most clearly articulated by the National Tax-Limitation Committee (NTLC), a nonpartisan group that advocates overall growth limits on local, state, and federal taxation (or expenditures). Others conclude that civil service systems and public employee unions have effectively precluded the possibility of achieving efficiency in government. But not all growth-limit proponents espouse these views; many take the more pragmatic position that specific conditions (such as inflation, the growth of regulation, and rising incomes and property values and the government revenues they generate) have nurtured the growth of the public sector. While they believe this growth should be controlled, they do not think fiscal controls should outlast the conditions that gave rise to the problem.

Most of the growth-limit measures enacted by state legislatures in the early 1970s reflect the pragmatic position; those placed on the ballot by citizen initiative reflect the belief that only permanent controls will correct the system's built-in spending incentives.

In addition to being more diverse in strategy and philosophy, the growth-limit approach also tends to be less restrictive and more flexible than Prop. 13 and its offshoots--not only because it does not force reductions in taxes or spending, but also because growth-limit measures often include features that soften or relax the fiscal control.

Such features include variable limits, override provisions, and arrangements for local expenditures that are mandated by higher levels of government. Variable limits (such as New Jersey's strategy of linking spending increases to growth in personal income) restrict government growth but allow it to keep pace with the state economy's growth (both real and nominal). Override provisions (such as Colorado's provision that the Division of Local Government can approve an increase in the property tax levy above the 7 percent limit) take uncertainty into account, and explicitly recognize the need for adapting to changed circumstances. Adjustments for state-mandated local expenditures (such as New Jersey's exclusion, from the local spending limit, of expenditures mandated by federal or state law) recognize the interdependence of the state and local fiscal system. Not only does Prop. 13 lack these features, but its requirement of extraordinary legislative or referendum majorities to increase or enact new taxes also puts significant veto power into the hands of a minority.

Both approaches to fiscal limitation lack what the NTLC calls a "total systems" strategy of fiscal limitation (Rickenbacker and Uhler, 1977, p. 18). Changing spending or taxing patterns at one level of government automatically affects the other levels. But few states have both state and local limits; of those that do, only New Jersey and Michigan adopted local and state limits as an integrated package. Hence, virtually all of the current fiscal limits have effects on other levels of government that received little consideration when they were enacted.

DISTINCTIVENESS OF THE PRESENT SURGE OF FISCAL CONSERVATISM

From reading the innumerable media accounts of the "taxpayers' revolt," one might easily conclude that Prop. 13, its offshoots, and its rivals, represent a new phenomenon on the American scene. But history reminds us that tax rebellion and protest is a time-honored American

pursuit, as witness the Boston Tea Party (1773), Shays' Rebellion (1786-87), and the Whiskey Rebellion (1794).

State controls on local powers to raise revenues have an equally long history. Local government taxation powers are prescribed by state constitutions and laws; the state reserves the power both to prohibit local jurisdictions from levying specific taxes and to specify how local taxes are raised. Thus, local governments can impose nonproperty taxes only as authorized by the state. Most states also have constitutional or statutory restrictions on the dominant source of local tax revenues, the property tax.

Although property tax restrictions can take several forms, the most common is rate limitation. Overall rate limits originated in the late 19th century, when public expenditures for roads and canals operated for private benefit increased sharply.[3] Rhode Island, Nevada, Oklahoma, and Ohio were among the first states to adopt them. These controls have been interpreted as an effort to limit the growth of the public sector rather than to reduce property taxes. However, because the maximum rates generally exceeded the prelimitation average rates, and because rising property values allowed assessors to increase the tax base, they "had little effect on the ability of local governments to finance public services" (ACIR, 1962, p. 49).

The next push for property tax controls arose from the Depression of the 1930s, but this tax limitation movement differed in intent and effect from those of the 19th and early 20th centuries. With the Depression the property tax base declined, incomes fell, and tax delinquencies rose (U.S. Bureau of the Census, 1941; Bird, 1947). Seven states responded by imposing new rate limitations on all local jurisdictions (or tightening old ones). Their intent was to reduce property taxes in a period of falling incomes and this goal was achieved--at least temporarily. In the short run, local budgets were also slashed and local government services suffered, until several states adopted a sales tax and used these new revenues to help out local

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[3] By overall rate limits we mean maximum property tax rates that apply to *all* taxing jurisdictions, as opposed to maximum rates that may be levied by specific local units or for specific purposes.

jurisdictions.[4] The long-term consequence of the Depression and the fiscal limits imposed during that period was increased dependence on state rather than local taxation (ACIR, 1962, p. 38).

The current tide of fiscal limitation, then, is not unique. The goals of modern growth-limit measures parallel those underlying the late-19th century controls. Similarly, the 1930s' emphasis on property tax relief has reappeared as the core of Prop. 13. Nevertheless, the current fiscal limitation movement entails some shifts in both how and where the limits are imposed, as discussed in the next section.

Recent Trends in Fiscal Limitation

As the economy recovered after the Depression, the push for overall fiscal limits on local governments faded away. Following World War II, incomes and property values rose, and property tax collections increased substantially: from $5 billion in 1946 to $18 billion in 1961 (U.S. Bureau of the Census, 1962). While this growth partly reflected increasing property values, better tax administration, and new construction, about one-third reflected higher tax rates (U.S. Bureau of the Census, 1962). Such adaptive responses as the seeking of special exemptions, lobbying for limit increases, and using special districts to raise revenues for particular services, allowed local governments to erode state fiscal controls on their revenue-raising powers. No new overall limitations on the property tax came into being until the early 1970s (ACIR, 1962, p. 37).

Shifts in Fiscal Controls Since 1970. The 1970s have seen the emergence of several new trends in fiscal controls. The first is a move away from the traditional limits placed on property tax *rates* to a broader limit placed on property levies (the *total amount* local governments collect in property taxes).[5] Kansas became the first state to

[4] For accounts of how stringent tax limits affected local public services, see Hillhouse and Welch, 1937; and Leet and Paige, 1936.

[5] As we discussed above, these controls typically take two forms: limits on the annual growth of property tax revenues, and full-disclosure laws.

enact such a limit in this decade. Its 1970 statute limited property tax collections in all cities, counties, and community junior college districts to the amount levied in 1969, but allowed increases in property tax revenues resulting from new construction, improvements, and added personal property.

By the end of 1978, at least 24 states had passed some form of limit on overall property tax revenues: only four of these controls were enacted prior to 1970 (see Table 4.1).

The shift toward levy-limits occurred because rate-limits alone have little effect during a period of rising property values and corresponding increases in assessment. But the shift was also due to the increasing reliance of local government on grants from higher levels and the growing importance of nonproperty taxes among local revenue sources. Federal and state aid to local governments increased from $3.5 million in 1948 to $26 million in 1969 (Puryear and Ross, 1978). Between 1957 and 1971, local revenues from sales and income taxes increased from $2 million to $7.5 million, or from 6 percent to almost 9.5 percent of all local tax collections (ACIR, March 1977, p. 27).

Without corresponding lids on property tax revenues, state attempts to lighten property tax burdens through increased state aid or options for new local taxes might founder. Kansas and Indiana enacted such limits at the same time that they allowed local governments to levy sales or income taxes; Wisconsin placed new controls on the growth of property tax revenues the same year that it began financing several functions that had formerly been funded by the counties. The desire to prevent local governments from realizing property tax "windfalls" (as a result of increased revenues from state or nonproperty tax sources) was no small part of the motivation behind the levy limits passed between 1970 and 1977. (It appears that many of the fiscal limits passed in 1978 (particularly those enacted as constitutional amendments) reflect somewhat different motivations--see below.)

The second post-1970 development is even more recent and marks the beginning of significant legislation imposing fiscal limits on the states. Since 1976, nine states have enacted limits on the growth of state expenditures or revenues and one (Colorado) had instituted

Table 4.1

STATES WITH OVERALL FISCAL LIMITS ON LOCAL GOVERNMENTS[a]

State	When Enacted			Breadth		Type		Focus	
	Year	Pre-1970	1970 or Later	General	Specific	Growth	Cutback	Property Tax	All Expenditures
Alaska	1976		x		x	x		x	
Arizona	1921	x			x	x		x	
California[b]	1974,78		x		x	x	x	x	
Colorado	1955,71,76	x	x		x	x		x	
Florida[c]	1971		x		x	x		x	
Hawaii[c]	1976		x		x	x		x	
Idaho	1978		*(d)*		x		x	x	
Indiana	1973		x		x	x		x	
Iowa	1976		x		x	x		x	
Kansas	1970		x		x	x		x	
Michigan	1978		*(d)*		x	x		x	
Minnesota	1971		x		x	x		x	
Montana[c]	1974		x		x	x		x	
Nebraska	1978		x		x	x		x	
New Jersey[e]	1976		x	x		x			x
New Mexico	1977		x			x		x	
Oregon	1916	x				x		x	
South Dakota[f]	1978		*(d)*	x	x	x		x	
Texas[c]	1978		*(d)*		x	x		x	
Utah	1969	x			x	x		x	
Virginia[c]	1975		x		x	x		x	
Washington	1973		x		x	x		x	
Wisconsin	1973		x		x	x		x	

For footnotes, see following page.

NOTES: *General:* Limit covers all revenues or expenditures.
Specific: Limit applies to the property tax.
Growth: Measure limits growth in revenues or expenditures.
Cutback: Measure reduces property tax revenues from existing levels.
Property Tax: Measure restricts growth in property tax levies or reduces property tax revenues from existing levels.
All Expenditures: Measure applies to all local expenditures.

[a]Included are limits on overall revenues or expenditures, limits on property tax *levies* (or total revenues collected from property taxes), and measures patterned after Proposition 13. Limits on property tax *rates* are excluded. As yet, there are no limits on overall revenues at the local level.

[b]California enacted an optional property tax levy limitation in 1974 (i.e., the levy limit could be substituted for freezing the property rate at 1972 or 1973 levels).

[c]Limit takes the form of a full disclosure procedure. A property tax rate is established each year that provides a levy equal to the previous year's. To increase that levy, the local governing board must publicize its intent to raise the property tax rate, hold public hearings, and approve the higher rate by a board vote.

[d]Passed in November 1978.

[e]New Jersey limits the growth in local spending to 5 percent a year.

[f]South Dakota's limit precludes increases in property tax and other tax levies without consent of the people by exercise of their right of initiative or by a 2/3 vote in each house of the legislature.

income-tax indexing (see Table 4.2).[6] New Jersey started the trend with its 1976 law that holds state expenditure growth to increases in personal income; Colorado and Rhode Island followed by restricting spending increases to 7 and 8 percent a year, respectively (1977); and Tennessee subsequently prohibited appropriations from growing faster than the state economy (March 1978). The November 1978 elections added five more states to the list: Arizona, Hawaii, Michigan, South Dakota, and Texas.[7] Of this group, four states have also enacted overall limits on property tax revenues,[8] and one (Michigan) ties all local revenue growth to increases in the Consumer Price Index.

Events of the Post-Jarvis Period

The 1970s have witnessed a definite trend, then, toward greater limits on the future fiscal resources of both state and local governments. While this trend continued to be reflected in the November ballot proposals, several new features emerged:

- o A return to efforts to cut back property taxes;
- o A shift toward more permanent limits on government; and
- o Greater citizen pressure for change.

Proposition 13 Offshoots. The months following California's landmark passage of Prop. 13 marked a rebirth of the effort to cut back property taxes, reminiscent of the 1930s. Close parallels to Prop. 13, two of which passed, appeared on November ballots in Idaho, Oregon, Michigan, and Nevada.

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[6] Arizona has instituted partial income tax indexing of deductions, credits, and exemptions. See Shannon and Weissert, 1978. California quickly responded to Prop. 13's passage by legislating partial indexing, and then full indexing in October 1979.

[7] South Dakota's limit differs from the others: It makes raising taxes more difficult by requiring either a 2/3 vote of the legislature or a citizen-initiated measure that is then approved by a majority of the legislature.

[8] Arizona, Colorado, Hawaii, and New Jersey. The first three passed local property tax limits before the state limits; New Jersey and Michigan passed state and local limits simultaneously.

Table 4.2

STATES WITH OVERALL LIMITS ON STATE EXPENDITURES OR REVENUES

State	Date Enacted	Focus		Type of Limit		
		Revenues	Expenditures	Variable	Fixed	Vote
Arizona	Nov 1978		x	x		
Colorado	1977		x		x	
Hawaii	Nov 1978		x	x		
Michigan	Nov 1978	x		x		
New Jersey	1976		x	x		
Rhode Island	1977		x		x	
South Dakota[a]	Nov 1978	x				x
Tennessee	Mar 1978		x	x		
Texas	Nov 1978		x	x		

[a]South Dakota's limit prohibits increases in personal or corporate income taxes, sales and service taxes, or allowable property tax levies (or percentages for determining values for taxes on real or personal property) unless "by the consent of the people by exercise of their right of initiative or by two-thirds vote of all the members elect of each branch of the Legislature." (Official Ballot of South Dakota, November 1978.)

Because groups in several states seek to place similar proposals on future ballots, the fate of the four Prop. 13 offshoots merits further consideration. The losing measures came in states with a previous history of property tax restraint: Both Michigan and Oregon have enacted a series of circuit-breaker laws that reduce the property tax burden for all renters and homeowners; Oregon passed a 6-percent limit on the yearly growth in overall property tax revenues in 1916. In contrast, Idaho's and Nevada's traditional property tax rate limits have little effect on restraining tax payments when property values are rising.[9]

[9]Idaho and Nevada have circuit-breaker programs, but they cover fewer people and cost far less per capita than the Michigan and Oregon programs. Idaho's property tax relief measures apply only to homeowners age 65 and over (plus special categories such as widows, the blind, disabled veterans, and fatherless children under 18), and its 1977 cost per capita was $4.67. Nevada's circuit-breaker program applies to renters and homeowners age 62 and over; its cost per capita is $2.20. In contrast, the Michigan and Oregon programs apply to all homeowners and renters and had 1977 costs per capita of $30.24 and $31.20, respectively (Shannon and Tippett, 1978).

While the California vote suggested that previous inoculation fails to immunize a state against radical fiscal limits, the November elections indicate that the immunization theory merits further consideration.

The elections also suggest that relatively high property tax burdens are not a sufficient cause for passing radical fiscal limits. Both Idaho and Nevada (where Prop. 13 offshoots passed) have lower property tax burdens than Michigan and Oregon (where Prop. 13 measures failed.)[10] These facts suggest that one should look beyond absolute property tax burdens to other factors. The relative size of and growth in tax burdens, historical tastes for public services, and political constraints on citizen action appear to be key determinants of fiscal limit success or failure.

In addition, voters in both Idaho and Nevada lacked the option to choose between radical and moderate proposals, whereas voters in Oregon and Michigan had that choice. To some observers, California's defeat of the more moderate Prop. 8 suggested that conflicting options give the edge to the more severe proposal. But Prop. 8's defeat was clouded by its failure to promise tax relief explicitly, coupled with the widespread publicity given to the sizeable increases in Los Angeles County assessments just before the election (Levy and Zamolo, 1978). In contrast with the California experience, the November elections suggest that radical action may be thwarted when voters face both moderate and severe choices.

Constitutional Limits. The November elections also indicate a shift toward more permanent limits on government: All but one of the eight fiscal measures approved in November were constitutional amendments. In contrast, all but one of the pre-November state limits and most of the pre-November local limits on overall property tax revenues were statutory enactments.

First, because constitutional limits are considerably more difficult to modify than statutory measures, they are frequently viewed as diminishing the options available to elected officials, and thereby

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[10] Local and state property tax revenue per $1000 of personal income for the four states in 1974-75 was as follows: Idaho (33.4), Nevada (43.5), Michigan (49.9), and Oregon (52.9). (See ACIR, March 1977, p. 48).

constitute--some would argue--a threat to representative government. The counterargument is that such amendments expand elected officials' options by making it easier for them to resist special-interest pressures for more spending. That issue cannot be resolved here. In any event, the erosion of earlier constitutional limits on property tax rates suggests that local governments will seek ways to stretch or circumvent recently enacted constitutional controls.

Such efforts inevitably generate unanticipated secondary effects. Arizona has had a 10-percent growth limit on county and municipal spending since 1921. Over the years, Arizona's local jurisdictions have pressured the legislature and the courts to exempt more and more spending categories from the law; currently, "half or more of a typical local budget may be free of the 10 percent limit" (*Wall Street Journal*, November 3, 1978, p. 1). In 1972, the lid on cities (but not counties) was raised to 15 percent for one year. Moreover, to keep the expenditure base as high as possible, most local jurisdictions have two budgets: a working budget "that reflects actual planned expenditures" and a public or legal one that contains padded appropriations in some areas and unrealistically low projected spending figures in others (*Wall Street Journal*, November 3, 1978, p. 21).

Because of these stratagems, the local budget process in Arizona is extremely complex. It is also calculated to thwart the most diligent citizen's efforts to find out how his taxes will be spent. But without such maneuvering, local adjustments for inflation or population growth would have been nearly impossible. The current spate of fiscal controls will likely produce similar strategies wherever changing demographic and economic conditions put pressure on the legal limits.

Citizen Pressure. The third post-Jarvis feature in fiscal limits is a corollary of the constitutional amendment resurgence: greater citizen pressure for change. Most of November's constitutional amendments were placed on the ballot by citizen initiative rather than by legislative referendum. Moreover, in many states that lack an initiative procedure, citizen groups are pressuring their legislators to place amendments on future ballots.

This citizen trend seems to reflect popular distrust of the responsiveness of elected officials--in particular, a belief that elected

officials are motivated to take advantage of inflationary effects on revenues, that they lack the capacity to resist interest-group pressures for expanding government programs, and that they waste the taxpayers' money. Considerable research has documented the erosion of the public's trust in government since the mid-1960s. More and more Americans have become convinced that the government cannot be wholly trusted to do what is right, that it squanders revenues, and that public officials are incompetent and care little what the average citizen thinks. This widespread drop in public confidence has recently coalesced into anti-spending sentiment. The November elections, in which voters approved the majority of the fiscal limit proposals on state ballots, clearly reflect these public concerns.

As we noted above, however, the public still gives the federal government first place as the most profligate spender of public money. Nevertheless, the apparent displacement of antitax and antispending sentiments onto local and state governments is not as irrational as it first appears. Because property tax payments are not withheld from earnings and typically come due only once or twice a year, they are both more visible and more immediately painful than other tax payments. A vote for property tax cuts brings sharper results than a reduction in one's withholding tax.

Moreover, citizen action to enact fiscal limits at the local and state level is less arduous than at the federal level: Citizens can place initiatives on the ballot in many states, but engineering a national constitutional amendment requires the approval of 38 states. Finally, the growing interdependence of local, state, and federal fiscal relations means that actions at one level will reverberate on the others. California's Governor Brown demonstrated this nexus when he froze state salaries just after Prop. 13; the California legislature followed suit with a partial income-tax indexing law.

The increase in citizen pressure for fiscal limits therefore has its roots in widespread dissatisfaction with government performance. Fueling that dissatisfaction are continuing inflation,[11] proliferating

[11]Inflation may increase property and income tax bills disproportionately. It may also provoke the populace into taking action against the only price on which it is permitted to vote, that of government.

government regulations, and an increasingly interdependent federal system that is more and more difficult for the average citizen to understand. While local and state governments do not necessarily get the worst report cards, they constitute the easiest targets for remedial action.

Viewed in this context, it was virtually inevitable that public pressure for fiscal controls would mount. It was also virtually inevitable that citizen groups would turn to more permanent forms of control--not because all or most citizens share Milton Friedman's belief that constitutional amendments are "our only hope" (Rickenbacker and Uhler, 1977, p. 4), but because the amendment route is the most direct channel for citizen action. Until the underlying causes of public discontent with government disappear, the trend toward citizen-initiated constitutional amendments is likely to continue.

ATTEMPTS TO EXPLAIN THE ADOPTION OF FISCAL LIMITS

What preconditions, then, appear to explain adoption of fiscal controls? Ladd (1978) performed a multivariate analysis of the factors that determined eleven states' establishment of local fiscal limitation measures in the period 1970 through 1976. She found the significant variables to be property tax revenues per dollar of personal income, the rate of growth in local expenditures per capita, and whether or not the state had imposed some form of control by 1962. The last variable was meant to capture political willingness to take action at the state level. We revised and updated her model in several ways: We added states that adopted measures between 1976 and 1978, including Tennessee, where the limit applied only to state spending. (Fifteen states joined Ladd's original eleven in the period 1976-1978.) We also expanded the list of explanatory variables by two. First, we used a dummy variable to indicate whether or not the state constitution can be amended through voter initiative, to reflect both the power of public opinion and the pressure this possibility may impose on legislatures to act in advance of popular initiatives.[12] Second, on the theory that urban voters

[12] In Massachusetts, an initiative must be approved by two sessions of the legislature before being submitted to the electorate for ratification. We gave Massachusetts a value of 0 for this variable.

desire more public services, we added a variable that indicated what fraction of the state population lived in metropolitan areas, hypothesizing that the higher the fraction, ceteris paribus, the less likely would be the adoption of state-local fiscal controls. We also revised the time spans over which explanatory variables were computed. Ladd measured the property tax burden in 1971 and the growth of expenditures for 1967-1971; we computed the tax burden in each state for the year before the enactment of a limitation measure, and the growth in expenditures for the five-year period preceding enactment. For states without fiscal controls, we measured expenditure growth the period 1965-1970 and the property tax burden as of 1970 (see Table 4.3).

As the following results indicate, our reformulation and testing of the model reinforced Ladd's findings with respect to property taxes and past history, but failed to confirm the other hypothesis:[13]

$$\begin{aligned} DUM = &-.7236 + .0143\ PRPTIN - .0243\ PR\Delta LEP \\ &(.4496)\ (.0048)\qquad\quad (.0313) \\ &+ .6919\ DUM62 + .0043\ PCMPOP - .1862\ DUMCON \\ &(.2067)\qquad (.0027)\qquad\quad (.1576) \end{aligned}$$

Although the signs and significance of the property tax (PRPTIN) and the measure of political willingness (DUM62) variables were similar to those reported by Ladd, the expenditure growth variable declined substantially in significance (and showed a reversal in sign). The amendment-by-initiative variable (DUMCON) was also low in significance and had a counterintuitive sign. When we ran Ladd's model with the original three explanatory variables--property tax and expenditure growth measured over her time spans with DUM62--to explain passage in the 26 states that had adopted limits between 1970 and 1978, the expenditure variable showed the same reversal in sign and diminished

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[13] Standard errors are in parentheses; $R^2 = .2755$. Ladd's (1978) results were as follows:

$$\begin{aligned} DUM = &-.7682 + 8.296\ PRPTIN + .9494\ PR\Delta LEP + .2240\ DUM62. \\ &(.3640)\ (3.854)\qquad (.4652)\qquad\quad (.1604) \end{aligned}$$

Table 4.3

DEFINITION OF VARIABLES TESTED FOR EFFECTS ON PROBABILITY OF IMPOSING CONTROLS

Variable	Definition
	Dependent
DUM	1 = states that imposed controls between 1970 and 1978; 0 otherwise.[a]
	Independent
PRPTIN	Property tax revenue per dollar of personal income in year prior to passage of limitation measure for states with DUM = 1; for year 1970 for others.[b]
PRΔLEP	Rate of change in local expenditure per capita five years prior to passage of limitation measure in states with DUM = 1; for years 1965-1970 for others.[c]
DUM62	1 for states with some form of local tax limit in 1962; 0 otherwise.[d]
DUMCON	1 if state constitution permits amendment by popular initiative; 0 otherwise.[e]
PCMPOP	Percent of state's population residing in Standard Metropolitan Statistical Areas (SMSAs) in 1970.[f]

[a]States with a value of 1 include Alaska, Arizona, California, Colorado, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Michigan, Minnesota, Montana, Nebraska, New Jersey, New Mexico, Ohio, Oregon, Rhode Island, South Dakota, Tennessee, Texas, Virginia, Washington, and Wisconsin. Although Georgia and Ohio do not meet our criteria for broad fiscal limits, we included them to maintain comparability with Ladd's analysis.

[b]U.S. Bureau of the Census, 1978.

[c]U.S. Bureau of the Census, 1978.

[d]Ladd, 1978.

[e]Rickenbacker and Uhler, 1977.

[f]U.S. Bureau of the Census, 1973.

appreciably in t value. It would appear, then, that something in the nature of a "limitation epidemic" had struck the country by the latter 1970s. No longer did a state need a high rate of local expenditure growth, nor did it seem to require a constitution amendable by the electorate, or a comparatively nonmetropolitan population, to succumb to the movement for spending controls. High property taxes and a history of limitations seemed to suffice in the era of widespread disenchantment with government.

THE EFFECTS OF FISCAL LIMITATION MEASURES

What have been the effects of measures adopted to limit the fiscal activity of state and local government? The only attempt to study the issue empirically seems to have been performed by the Advisory Commission on Intergovernmental Relations (ACIR, February 1977). The author found, using multivariate analysis, that in states that had adopted fiscal limits in 1974, local expenditures would have been about 7 percent higher had no such limitations obtained. It should be noted that recent, more restrictive, controls were not examined. Ladd also argues that by working with a snapshot technique across all states, the ACIR study failed to take into account the possibility that states with initially higher levels of expenditure may have gravitated toward formal limitation measures, meaning that the estimates may understate the actual reduction induced by fiscal limits (Ladd, 1978). To analyze the phenomenon properly, a more elaborate model and time series data for individual states seem required.

CONCLUSIONS

Our examination of past and recent fiscal limits makes the following points:

- The current surge in fiscal restraint is not unique: Tax revolts and fiscal controls go back to the beginning of our nation's history; moreover, current approaches to fiscal limitation espouse goals parallel to those of the movements of the late 19th century and the Depression years.

- o Nevertheless, fiscal limits enacted since 1970 differ from earlier measures in both how and where they are imposed. Comparing the pre- and post-1970 periods, we see: (1) a switch from controlling property tax rates to an emphasis on limiting overall property tax revenues; and (2) a trend toward imposing controls on state as well as local governments. Comparing the pre- and post-Proposition 13 eras, we detect a move toward more permanent limits initiated by citizen groups rather than by state legislatures.
- o Current approaches to fiscal limitation vary sharply in their goals (some seek to cut back revenues, others to limit future growth). Growth-limit measures, because they do not impose reductions in revenues or expenditures and permit exceptions to the legal limits, are less restrictive than Prop. 13 variants. Both sorts of measures tend to neglect consideration of the fiscal interdependence between state and local governments.
- o Past limits spurred attempts by local governments to erode or circumvent fiscal controls, efforts that typically had unanticipated secondary effects. The current rash of constitutional amendments will likely produce similar results. Understanding the overall effects of fiscal limitations will require further study (see Chap. 5).
- o There is no simple relation between the characteristics of the state and the passage of fiscal limitation measures. Citizen pressure for fiscal limits has its roots in widespread dissatisfaction with government performance, a dissatisfaction that is fueled by proliferating government regulations and continuing inflation. Until the underlying causes of such discontent disappear, the trend toward formal fiscal limits is likely to continue--and to focus on the easiest targets for remedial action, state and local governments.

These conclusions foreshadow several effects of fiscal limitation. Just as the Depression-era limits increased local dependence on state taxation, the current movement can be expected to accelerate existing

trends toward centralization of the state-local fiscal system. Between 1967 and 1977, the state share of state-local expenditures grew substantially in more than half of the fifty states (Puryear and Ross, 1978). This trend will probably accelerate because of the dominance of local controls in the current fiscal limit universe.

Will home rule then become the ultimate victim of higher level bail-outs to needy localities? Many would argue yes, citing the steady encroachment of state and federal regulations and mandates on local autonomy. But whether operational control follows hard on the heels of fiscal control is still an open question. For the states to exert control over the content and quality of local services requires both state willingness to assume the responsibility and local acceptance of state dominance. As yet, we have no conclusive evidence on either issue.

As the Arizona experience indicates, fiscal limitation also produces incentives for budget obfuscation. Local governments can also be expected to devise stratagems for loosening or circumventing fiscal controls, especially when demographic or economic changes cause pressures for exceeding the legal limits. Such unanticipated reactions may serve to exacerbate the increasingly byzantine process of budget-making.

The diversity of fiscal limit measures means that their economic and political effects will vary from state to state. If controls apply only to property taxes, local reliance on sales or income taxes and on state and federal aid will likely increase. Because most fiscal controls have not been enacted as an integrated state/local package, adjustments at one level will likely have unanticipated effects on other levels of government. Although more than twenty states have enacted overall limits on local revenues or expenditures, only nine have imposed limits on state growth. We expect the trend toward state-level controls to spread; the extension promises to reduce even further the revenues available to local governments. The net effect may be increased pressure on the federal government for financial aid to both local and state governments.

Chapter 5

A RESEARCH AGENDA ON THE POLITICAL AND SOCIAL CONSEQUENCES OF FISCAL CONTAINMENT

Fiscal containment of local government will generate a wide variety of consequences. Here we emphasize those with political and social side-effects. Wise policy requires knowledge; the research suggested in this chapter can help illuminate the choices for decisionmakers by identifying resultant changes in the distribution of power and well-being across various subgroups of the population. We have selected revenue systems, service packages, and public employment patterns of state and local governments as ultimate targets for analysis.

Once containment hits--induced by any of a variety of events ranging from tax-base declines to constitutional amendments--a series of reactions will ensue. Some of them are predictable; others may occur only under certain conditions. The attempt to trace the likely responses and adaptations is a necessary first step in identifying potentially adverse consequences that must be anticipated and, if possible, minimized.

The first round of responses will take place at the level of federal and state government. How will grant-matching and mandated program standards be enforced? Will the magnitude of subventions to local government diminish? Will the power to design and operate traditionally local programs shift to state or federal government?

The second round of responses will occur in local government itself.[1] Elected officials and managers will have to estimate the new yield on the tax base and what can be expected from state and federal grants; they must then decide whether and how to raise new revenues, what services to trim, if that becomes necessary, and how to reduce the cost of government, with inevitable results on the size of the public work force.

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[1] See the symposium on "Organization Decline and Cutback Management," edited by C. H. Levine (1978).

Finally come the impacts on residents of affected jurisdictions. The distribution of tax burdens may well shift and alter the after-tax welfare of various subpopulations. Service cutbacks may harm some groups more than others. Reductions in public sector employment opportunities may also affect various segments of the population differently.

RESPONSES BY HIGHER-LEVEL GOVERNMENT

Calls upon federal and state government to "bail out" localities in fiscal straits may lead to one sort of response. Reactions in the opposite direction may result from local failures to maintain precontainment program operations, the mandates of which are often built into grant formulas.

Federal Responses

Several federal agencies have issued reports on the implications for the federal government of Prop. 13 and similar fiscal limitations, the first report being that of the Congressional Budget Office (1978). CBO estimated that federal revenues should increase by about $600 million in FY 1979 and $900 million in FY 1980, because of the loss of deductions by California income taxpayers. Total federal expenditures will not be significantly affected. The report predicted that expenditure cutbacks could lead to lower federal spending in California by reducing the state's participation in federal grant programs that have maintenance-of-effort requirements. However, since the issuance of the report, it has become clear that the subsequent bail-out from Sacremento and various features of maintenance-of-effort requirements mean that, in the near term, federal aid to California will not drop substantially.

The Comptroller General of the United States (1978) reviewed 52 federal assistance programs (those exceeding $100 million) with matching and/or maintenance-of-effort requirements and formula-distribution requirements, to ascertain how Prop. 13 affected them. Of those programs, 32 require matching; the report speculates that the impact of matching requirements may be softened for several reasons: (1) In-kind resources may be used to match, (2) federal funds may be used to match,

(3) in many cases, state and local governments spend far more than the minimum required, (4) many programs allow statewide rather than local matching, (5) a number of programs allow proportionate reduction in the federal share.

A total of 37 programs require maintenance of effort. The impact of these requirements may be mitigated as well: (1) 15 programs allow waivers, (2) in many cases federal agencies are permitted to judge whether nonfederal reduction would have occurred in the absence of federal funds, (3) outdated base periods lessen the impact, (4) many programs require only a proportionate reduction in federal funds, and (5) maintenance of effort for a number of programs may be accomplished at the state level.

Some maintenance-of-effort requirements are stringent enough, however, to result in the withdrawal of federal aid. Thus, some jurisdictions may be faced with the need to reallocate funds to avoid the loss of federal aid.

Fully 93 federal programs distribute money to state and local governments by formula. According to the Comptroller General's report, it is difficult to assess whether fiscal limitation will affect aid under these formulas. In some programs, state expenditures are a factor; in others, state and local expenditures are factors; in still others, federal aid is related to taxing effort. An example of the latter is General Revenue Sharing (GRS), but for that program the impact will not be felt for two years, because the data base lags. In the meantime, GRS is scheduled for reauthorization in 1980 and adjustments in the formula can be made.

The Lawyers' Committee for Civil Rights Under Law (Long and Likes, 1978), under contract to HEW, analyzed maintenance of effort, nonsupplantation, excess cost, and matching requirements in 11 major federal education programs. The question addressed was whether reductions in funds at the state or local level would violate these requirements, thus triggering, for localities, a reduction in federal aid as well.

The Committee concluded that moderate reductions in state and local funding do not appear to threaten maintenance of effort, nonsupplantation, excess costs, or matching requirements, particularly if political pressures predispose federal officials to liberal interpretations of the

requirements. Moreover, strict enforcement of the requirements is not easy, even in principle. It would thus appear that the standards applied in federal grant programs are flexible enough to permit aid to locals to continue with minimal diminution.

Federal initiatives in response to the nationwide sentiment of fiscal conservatism are also possible. The federal government can limit taxes or spending or mandate balanced budgets for itself. Whether any of these actions will occur remains to be seen. Drastic limitations on federal taxes--such as the Kemp-Roth bill or a constitutional amendment--promise such monumental curtailment that the future of these measures is hard to predict.[2] Uncertainties also cloud the picture for limitations on federal spending. If serious limitation actions are taken at the federal level, they will compound the problems of financing the local public sector.

The near-term effect of the fiscal limitation movement at the federal level may well be to increase interest in governmental efficiency both within the federal government itself and in the programs supported by federal funds. Efficiency reforms are far less controversial and can be made to look like a response to the spirit of the times. In recent years, the federal government has adopted--and attempted to adopt--a number of actions intended to improve budgeting and ultimately to control costs. These have included the creation of the Congressional Budget Office, to complement the President's Office of Management and Budget, as well as specific decisionmaking techniques such as program-budgeting and zero-based budgeting. Interest in these techniques and others will grow. Since the passage of Prop. 13, there has been a renewed interest in the long-languishing proposal to have a general sunset law (Senate Bill 3366, for example). Other symbolic responses to the movement will also occur. Actions that limit the size of the federal work force ("hiring freezes") and strengthen the management of the government will be offered as remedies. Such measures are more

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[2] Those "fiscal conservatives" who voted for Kemp-Roth also voted for what Congress Watch (a small, nonprofit, public-interest group) called "corporate welfare" bills which would give major new federal assistance to private corporations.

acceptable than general tax and spending controls because they are less threatening to established interests and promise to increase efficiency and contain costs.

The consequence of strengthening the management of the federal government may be to eventually increase the zeal with which it attempts to control the expenditure of federal funds by circumscribing state and local behavior more carefully. Thus, a levelling-off in the growth of federal expenditures may be associated with an increase in regulatory activity on the part of the federal government. Fiscal conservatism could lead to more, not less, federal control. (The federal response to local fiscal crises, as in the case of New York City, may elicit more federal interference in local affairs as the price of emergency federal aid.)

State Responses

An increase in the prominence of state government in local fiscal affairs is also a result of fiscal limitation measures such as Prop. 13. The state of California rescued local government by providing $4.1 billion to counties, municipalities, and special (including school) districts after June 1978 and a slightly greater amount for the 1979-80 fiscal year. The state also assumed the preexisting local costs for welfare and health care assistance. Even though the second year's bail-out legislation includes a plan for permanent assistance to local government, many political observers doubt its permanence and believe that local officials share this doubt, too (*Tax Revolt Digest*, August 1979). So far the state legislature and executive agencies have been loath to intrude into the management of service delivery even as they assumed greater financial responsibilities. However, some would argue that political and bureaucratic pressures will inevitably push in the direction of greater state-level intervention.

Still, several forces are at work that will inhibit the growth of state power, both financial and managerial. Even without formal expenditure control measures directed at them, states may become more reluctant to pump money into local government. The "Spirit of Prop. 13" is alive in the land. Pressures to cut state taxes are manifest, as shown

in the current drive for indexing state income taxes, which have proven a veritable money machine during the inflation of the 1970s and which, as mentioned, have contributed to the accumulation of state surpluses. In California, it is estimated that Sacramento's income tax receipts grew by $1.50 for every increase of $1.00 in the personal income of taxpayers. Indexing will keep such figures in closer balance so that surpluses at the state level may soon begin to diminish. California enacted full indexing into law in October 1979.

In sum, state-level expenditure controls, the pressure for tax-cutting in state capitals, and the imminent disappearance of surpluses, when considered together, suggest that local governments cannot rely much longer on state grants to maintain current spending levels. The nominal value of federal grants-in-aid is not likely to diminish much soon, however, because matching and maintenance-of-effort terms are bendable and because formal fiscal limits at the federal level seem a long way off.

RESPONSES BY LOCAL OFFICIALS

A change in the rules by which the public sector operates will bring about responses by those local officials--politicians, bureaucrats, managers--who supply public services and arrange for their financing. Because these effects of fiscal contraction will differ from effects associated with tax increases, which have received considerable attention, they will require nontraditional analysis.

A shrinking tax base, or a fiscal limitation measure, will impel officials to try to offset revenue losses. They may, for example, seek ways to make up those losses, or they may attempt to shift, to other levels of government, activities that cause net resource drains on their revenue pools. Municipal, county, and district governments may ultimately have to reduce the level or quality of public services, across the board or selectively. Many of the avenues through which fiscal limitation or fiscal stringency can be offset may not emerge in conventional budget or taxation studies, but will, nonetheless, affect the incidence of payments for and receipts of public services.

Sources of Revenue

De jure Analysis. When voters institute fiscal limitation directly, or do so indirectly by refusing to allow the public sector to expand tax bases or tax rates, the outcome is a two-stage change in the incidence of payments for public services. The first of these stages we term "*de jure*." *De jure* analysis would portray the shift in tax incidence that results from the initial change in financial situations. Through Prop. 13, for example, California voters placed strict limits on one of the principal sources of revenue for local government, the property tax. This limitation has implications for the overall incidence of tax payments by California taxpayers. If public services are to be maintained at their previous levels, more of their support must now come from other major revenue sources, such as state income taxes and sales taxes. If, therefore, as some public finance economists argue, property taxes are more progressive than other tax sources, Prop. 13 will reduce the overall progressivity of California tax payments.[3] The degree to which property tax reductions may eventually redound to the benefit of renters is also part of the necessary incidence calculation.

The state's decision to "temporarily" offset revenue losses brought about by Prop. 13 through expenditures of the state surplus (the so-called "bail-out" legislation) will again alter the overall incidence of California taxes in generally predictable ways, as will the interrelated nature of tax obligations (e.g., the deductibility of property taxes from the state and federal income tax base). The exact magnitudes of these *de jure* shifts in tax incidence will depend on specific situations and on the nature of tax incidence by tax types. Needed are tax-elasticity statistics by income level, location, tenure, and other classifications, and an assessment of the extent to which fiscal contraction alters the incidence of state and local tax burdens among social and economic classes *in the absence* of adaptive responses by the public sector.

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[3]For a general review of this topic, see Aaron, 1975; for an opposing view of the incidence of property taxes, see Hamilton, 1978.

De facto Analysis. This phase of analysis should emphasize the gap between the *de jure* changes in tax incidence described above, and the actual incidence pattern that eventually emerges in the wake of fiscal contraction. This gap between *de facto* and *de jure* taxpayer burdens will arise because fiscal limitation or, more generally, changes in fiscal settings, will induce certain responses by those who directly control public sector revenue sources. Predicting the nature of these responses and assessing the validity of the predictions against actual circumstances are the principal intermediate goals of such an analysis.

The nature of bureaucratic response to fiscal containment depends first on the objective function that governs bureaucratic behavior. There are a number of prominent theories of public sector behavior, each based on a different assumption of officials' objectives and goals. (Inman (1979) provides a comprehensive review of economists' writings on this topic.) These theories range broadly in their views of the political process and of the incentives that govern bureaucratic behavior, from models in which each political party attempts to maximize votes, to models in which each separate bureau attempts to maximize its own budget, to models in which each bureaucrat exhibits maximizing behavior in response to his or her own career incentives. There are also theories of legislative response developed by political scientists that stress the differences between symbol-oriented electoral politics and the subsequent political bargaining in which the details of distributional effects are hammered out (Sonenblum et al., 1977). Each of these models generates its own predictions with regard to the reactions of the local government sector to declining budgets. Public decision-makers may choose, of course, to simply scale down spending, which will result in reduced service availability or quality, or both (see below). But if the revenue base shifts, as described above, then so will relative tax incidence.

Local officials may, of course, attempt to offset revenue losses that result from fiscal contraction. If we rule out, for the moment, the possibility of simply replacing revenue losses with new local taxes or higher tax rates on existing bases, we are left with three major avenues through which public officials can recapture some of the revenue loss: (1) fees for services; (2) "privatization"; and (3) shifts in

responsibilities for finance or service provision to other levels of government.

Fees. One way to recapture revenue loss is to treat certain public assessments as user charges for specific services rendered. People tend not to view user charges as taxes. (In California, however, a bill is pending in the legislature and an initiative campaign is under way that would restrict financing through fees.)

The *Wall Street Journal* (June 1, 1979) in its first-anniversary assessment of Prop. 13, remarked on the growing use of fees. "In the year since Californians voted themselves a deep cut in property tax payments under Proposition 13, they have been increasingly confronted with new or rapidly escalating fees, charges and other costs for services and programs local government previously paid for from general revenues . . . the nontax-deductible fees are a particular blow for the large number of renters in the state who received little, if any, benefit from last year's initiative."

Although the aggregate of revenues generated is still modest, fees have been initiated or increased for summer school, museum admissions, recreation facilities, building permits, fire inspections, dog licenses, and emergency ambulance transportation, to name a few applications. If that practice spreads, user charges may one day completely offset the revenue loss from tax reductions.

That possibility suggests a number of important research questions: What are the characteristics of public goods and services that lend themselves to fee-for-service assessments? Which functions of government are likely candidates for payment through fee for service? Does a mandatory fee for service (everyone must pay in a given locality) have the same effect on the distribution of burdens as does a general tax? These and related questions bear importantly on the incidence of payments for service provided by the public sector.

Privatization. There are at least three varieties of privatization.

One is *contracts*, under which the government pays a private firm to produce and deliver a service to its specifications. (Maintenance functions are often handled in this fashion; in this case, the government usually passes the costs along to its taxpayers.)

The second is *regulation of private provision*, in which the government determines which private firm provides the service and (most commonly) establishes the fees it may charge service recipients. Franchises are the commonest example. (Refuse collection is so treated in many municipalities).

The third is *abrogation of any public role*, whereby local governments have no explicit policies as to which private firms may provide the service, how they charge fees, and so on. (When summer schools were terminated after Prop. 13, private and voluntary groups offered substitute programs in many communities).

Certain services are prime candidates for privatization. Sanitation--except for the possible public health and amenity spillovers generated by underconsumption--is an obvious example. For other services (courts and corrections, for example), privatization seems much less appropriate. Civil service regulations and collective bargaining agreements may, of course, pose legal and political barriers to privatization. If private services replace public, the shift in financing mechanisms will generate equity effects.

Shifting Financial Responsibility. A third way to avoid the consequences of fiscal decline is a selective shift of financial responsibility from one level of government to another. The usual situation is a shift from local to state, or from state to federal levels of government. Since the various levels of government rely on different tax bases, shifts in final incidence will naturally occur. (On this topic, see Zimmerman, 1973, and ACIR, July 1976.)

Service Levels

Background. A recent article in the Los Angeles *Times* (Boyarsky, 1979) reviewed the effects of Prop. 13 about a year after its adoption. Major reductions were found to have occurred in summer school and adult education, library operations, and the maintenance of public facilities. Severe cuts in human service activities were avoided with the help of state bail-out funds and the continuation of federal grants. (See also Stumpf and Terrell, 1979; Northern California Foundations Group, 1978.) But future funding is less certain.

Whether it takes the form of cutbacks or slowed growth, fiscal containment will affect service delivery by local governments. Here we describe needed research on service levels as they are influenced by fiscal stringency.

Inman (1979) synthesized the views of many economists when he recently stated that we are not very close to understanding the effect of fiscal policy on local service output. He went on to argue that "Sound empirical analyses will require four ingredients: (1) measures of public outputs; (2) specification of production technology [including, we would add, the role of citizens in the coproduction of such services as public safety and education]; (3) a behavioral model of bureaucratic decisionmaking or output allocation, technology selection, and output mix; and (4) . . . behavioral models of . . . integration and private sector provision."[4] Political scientists have explored models that incorporate motivated adaptive behavior. Sonenblum et al. (1977), for example, hypothesize that when local officials are deciding how to deliver services, they make tradeoffs between production on the one hand and control (financial and regulatory) on the other, but are constrained by the service delivery structures perceived as available in their own specific political contexts. The research scheme presented here is designed to accommodate some of the issues raised by economists and political scientists.

Required Research. There is widespread conviction that the expansion of local government in the 1960s and early 1970s especially benefited the poor, minorities, the elderly, and the handicapped. The plight of these disadvantaged groups jolted the national conscience and helped them gain more government services, both absolutely and relatively. As growth slows or actual decline occurs in local governments, services targeted on the poor and other groups who have little political clout may be the first to suffer. Such an eventuality would follow from

[4]Integration (racial and social) is important because it generates what Inman calls "peer group" effects, as when, for example, the educational benefits to disadvantaged children increase as the proportion of advantaged children rises in their schools.

the perception that tax limitation is pushed by a middle class that now wants to maintain the services it uses, but cut its taxes.

While concentrating on services consumed by the disadvantaged, the research should explore how containment of local government affects the relative positions of service recipients in different categories of income, race, and location (e.g., urban vs rural).

Such studies probe important but complex topics. Consequently, they require a wide range of data--both objective information on expenditures and subjective evidence on perceptions, preferences, and political processes--to answer the following sorts of questions:

- What kinds of services are most affected by cutbacks or the end of growth in local government? For example, are social agencies harmed more than fire departments? Are services with a specialized clientele reduced more than those with widespread appeal?
- Whatever the agency, are there disproportionate cuts in services targeted to the poor, minorities, the handicapped, children, and the elderly?
- Are services to the poor cut less in cities with a large and vocal poor population? That is to say, does the political process adjust service-cuts according to the power of client groups?
- Do new or recently expanded programs suffer disproportionately large cuts because they do not have an established constituency?
- What are users' perceptions of changes in service levels? Are their perceptions accurate? Do they conclude that cutbacks are especially directed at them or that they are fairly distributed?

Statistical analysis could test hypotheses using government expenditure data. The percentage change, after fiscal contraction, might be generalized in relation to three types of explanatory variables: (a) those which describe an agency, (b) those which describe fiscal

fiscal conditions in the jurisdiction, and (c) those which describe the jurisdiction's population. Ideally, these questions ought to be examined in jurisdictions differing in size and demographic composition and differing as well as to source of fiscal contraction (e.g., explicit tax limit or expenditure cap, erosion of tax base, and the like).

Local Public Employment. Since salaries and fringe benefits account for about 80 percent of the costs of state and local government, scale-downs in real local spending, however caused, will almost certainly decrease the real employee wage-and-benefit bill. But how much will employment levels fall relative to compensation? And if employment reductions occur, how will they be distributed by function, occupation, age, sex, and ethnicity of employees? Because there is strong interest in both the overall efficiency and the distributional consequences of fiscal containment, the eventual pattern of employment and wage reductions merits attention.

Any cost-cutting strategy adopted in the public sector is likely to be more sensitive to job protection than would be its equivalent in the private sector. Public decisionmakers, after all, differ from their private sector counterparts in at least three aspects:

- Their own job survival is not so closely tied to a periodic financial accounting.
- Employees are voters (and often help finance election campaigns). In a sense, government jobs per se are part of the package of public benefits.
- The distributional consequences of any action will matter more.

Such considerations ensure that public sector managers, be they elected officials or appointed administrators, will operate from a peculiarly complex set of motivations that will generally predispose them toward job-saving solutions. The growing strength of public sector unions, civil service regulations, and affirmative action requirements adds further complexities.

Research Directions. Appropriate research strategies for studying employment effects would generally parallel those described above for

analyzing changes in service packages. In addition, however, it may be advisable to collect information through surveys on the fate of terminated public employees, characterized by jurisdiction, agency, and such worker characteristics as occupation, experience, sex, and ethnicity.

While large cutbacks will almost inevitably lead to layoffs, we hypothesize that many cities faced with moderate cutbacks will favor strategies that minimize the number of discharges. These include the across-the-board hiring freeze, which permits attrition to take its toll, and the reduction of real compensation through the slowing of nominal increases. Pressure exerted by public employee unions, when combined with civil service regulations, generally works to preserve the job rights of more senior employees when terminations become necessary. The effects are borne by workers with low seniority status--the young, women, minorities.

On the other hand, when attrition is permitted to run its course, the results may also be perverse. Agencies that happen to employ more workers near retirement age than other agencies will shrink disproportionately. If real wages decline for public employees at the same time, the most productive workers may leave for jobs in the private sector. Similarly, the prospect of reduced career opportunities may induce the most mobile workers, often the youngest, to leave. Fiscal hard times may suggest to workers an eventual erosion in pension benefits and provoke a wave of early retirements. The net results of a freeze-plus-attrition policy are difficult to predict, but may well have long-term effects that are arbitrary from the perspectives of efficiency in the public sector and equity in society.

Research is also required in situations where selective as opposed to across-the-board cuts are made. Some agencies will do fairly well, others poorly. Decisionmakers will seek to economize by reducing hours of operation, consolidating agencies, and bucking responsibilities to higher levels in the governmental system. All such actions will affect employment and perhaps compensation levels. Certain services, agencies, or programs--and thus their payrolls--may be insulated from cutbacks by strong employee or client groups. The electorate may perceive that

a particular service is valuable and efficiently provided and that others are less so. These perceptions translate into priorities, and decisions, for the sensitive politician. To forecast eventual employment outcomes requires the ability to estimate the consequences of these interrelated processes.

Even if true cutbacks do not occur, slowed real growth in local governments will change important circumstances of public employment. With less hiring, fewer new faces will invigorate old organizations. Limited opportunities for promotion will cause valuable employees to go elsewhere, particularly if the private sector is expanding. Affirmative action commitments will be more difficult to meet. Many observers believe that government employment has contributed substantially to minority advancement during the recent past. Blacks, particularly, have in recent years benefited disproportionately from jobs in the public sector, which has proven more hospitable to them than has the private. In addition, the skills and experience accumulated have often been transferable to the private sector. Curtailed hiring and limited opportunities for promotion will weaken the government contribution to minority advancement. The effects may be intergenerational. Reductions in opportunities for today's minority workers may slow the social mobility of succeeding generations.

Some Pertinent Facts. In California, where financial contraction hit hardest as a result of the efforts of Jarvis and Gann, actual work force reductions occurred. In the summer following the passage of Prop. 13, cities, counties and special districts in the state laid off 8500 employees (regular plus CETA), according to California's Employment Development Department. Although discharges soon moderated, attrition continued to take its toll as governments failed to replace employees who retired or quit. From 1973 to 1977, state and local government had been rising 3 to 5 percent per year; in the summer of 1978, the work force fell by 0.5 percent. The UCLA Business Forecasting Project estimates that whereas state and local employment in California would have risen from about 1,460,000 in June of 1978 to over 1,600,000 by the end of 1980, Prop. 13 will result in a reduction to fewer than 1,300,000 by then. The Employment Development Department (1979)

estimates that public payrolls in California fell by 103,000 in the year following Prop. 13. Of this total, county employment reductions accounted for 11 percent, while municipal and school district employment cuts accounted for 15 and 69 percent, respectively. (The school figures were largely due to the phasing out of summer school.) The remainder was made up of much smaller cuts in federal, state, and special district employment.

As the largest municipality in the state, Los Angeles is certainly important, and according to the evidence in Chap. 3, seems typical of large California municipalities. Table 5.1 traces the course of events in City employment since the passage of Prop. 13. (Most reductions were the result of natural attrition, not layoffs.) By April 1979, total employment had fallen 8 percent from the July 1978 figure and was almost 16 percent below the proposed pre-Prop. 13 budget. The declines for CETA employees were 25 percent and 41 percent, respectively. What the future will bring depends largely on arrangements for future bail-out funding from the state, but significant losses in opportunities for public employment have already occurred, particularly for low-skilled minority workers who might have sought CETA jobs.

Cities with eroding tax bases have already had to take strong action to reduce the municipal work force. According to Peterson (1978, p. 70),

> Cleveland's public employment is down 16 percent in the course of three years. Real wages also have declined over the last five years . . . Pittsburgh trimmed its labor force by 20 percent, more than 2,000 employees . . . even reductions of 20 to 25 percent in the [municipal] labor force may not suffice to balance the local budget.

Although the concentration of minorities in the government sector has yet to emerge as strongly in the West as it has in the East, minority workers in the East, including professionals and white-collar employees as well as the unskilled, are increasingly dependent on public employment. Should Prop. 13 fever hit Maryland or Michigan or Pennsylvania, or should fiscal conservatism and the erosion of tax bases intensify in such areas, minority employment would suffer severely.

Table 5.1

TRENDS IN CITY OF LOS ANGELES EMPLOYMENT, JULY 1978-APRIL 1979

Month and Year	CETA Positions	Regular Positions	Total Employment
July 1978	4415	26,902	31,317
October 1978	3946	26,149	30,095
January 1979	3634	25,671	29,305
April 1979	3333	25,402	28,735
Proposed budget for 1978-1979 (before Prop. 13)	5621	28,393	34,014

SOURCE: Letter from Councilman Marvin Braude, Chairman, Finance Committee, Los Angeles City Council.

By 1974, in Baltimore, Detroit, Newark, New York, and Philadelphia, blacks held a sizable share of public jobs (ranging from 60 percent in Baltimore to 31 percent in New York). In most of these cities, the fraction of public sector jobs held by blacks far exceeded the fraction in the private sector (Peterson, 1976, pp. 112-115). In recent years, as blacks have improved their position in the job market, newly created positions in many cities have been concentrated in the public and not the private sector. Also, governments are probably somewhat more receptive than business firms to demands for equal opportunity. The consequence was that between 1960 and 1970, 60 percent of the increase in black professional and managerial employment--and only 40 percent of the white increase--occurred in the public sector. In the 15 years preceding 1975, the public sector supplied 40 percent of the new jobs gained by blacks (Erie and Brown, 1979, pp. 20, 22). As to specifics, "The Baltimore city school system alone employs about as many black professionals as does the private sector of the entire metropolitan area . . ." And local governments have provided a substantial demand for the services of minority businesses and skilled labor. " . . . in 1975, 29 percent of all black construction workers employed in the entire country were at work building the Washington, D.C. subway system." (Peterson, 1976, p. 115.)

In responding to fiscal problems, city governments subject to collective bargaining agreements and civil service regulations, tend to terminate low-seniority workers first. These workers are disproportionately minorities. As a result, when New York City, for instance, reduced its municipal labor force by 13 percent as a consequence of the financial crisis of the mid-1970s, "half the City's Spanish-speaking workers lost their jobs, as did 40 percent of the black males . . ." (Peterson, 1976, p. 114).

EFFECTS ON CITIZENS AND TAXPAYERS

The analyses of changes in service outputs and tax (or fee) payments need to be integrated, so that they can enable empirical estimates of net changes in household welfare caused by fiscal containment. That process will require a data base--not yet in existence--that links household characteristics with tax payments and public service consumption. Pre- and post-containment data on consumption of and payments for governments services could be collected from a survey of citizens. Alternatively, one could simulate the effects of changes in service packages and financing systems on households with varying characteristics.

There may be no single "best" method for analyzing the effect of fiscal stringency on the incidence of payments for public services. Traditional incidence analysis would take the preexisting distribution of public revenues by tax types, estimate the incidence of each tax type by income and other categories, and calculate a weighted average incidence for the entire tax system. The post-fiscal containment calculation of tax incidence would proceed along similar lines, using the new tax shares generated by the changed fiscal setting. One would then compare average incidence figures for the two periods, and thereby deduce how a particular fiscal limitation measure or a particular fiscal-stringency setting affects tax liabilities.

If, however, officials attempt to offset revenue losses and do so along one or another of the lines outlined above, a traditional tax incidence analysis may produce a distorted picture of change in the resulting *burden of payments* for publicly supplied services. Of the three principal avenues through which local officials can move to offset

revenue losses, two--fees for services and privatization--would disappear even in a multigovernmental incidence analysis, because user charges and prices paid for privatized services are not taxes. And yet, from an equity standpoint, it is not simply the relative shares of various taxes paid by low- and high-income groups in pre- and post-containment worlds that matter, but rather the effect of fiscal containment on the burden of *payment* for the bundle of public services supplied in the pre-fiscal-containment world.

An example may help to clarify this point. Assume that before limitation of property taxes, sanitation services were supplied by local governments and supported out of general revenues. Suppose also that after establishment of the tax limit, the supply of sanitation services shifted to the private sector. In the private sector there will be, in general, no distinction by income class in the fee charged for sanitation services. So long as property taxes contain at least an element of progressivity, the pre-containment setting can be viewed as one in which the supply of sanitation services by the public sector is partly an income redistribution mechanism. But, in the post-fiscal-containment world, the subsidy to lower-income groups has been eliminated. Even were the average tax incidence figures identical for the tax systems in the two periods, this abandonment of a subsidy to a low-income group will alter the incidence of *total* payments for service.

A similar line of reasoning would hold for publicly supplied services that were funded out of general revenue sources before containment, and subsequently by direct fees-for-services. Thus, the greater the degree of response by officials to fiscal limitation or fiscal stringency, the more likely are there to be important differences between the incidence of tax burdens and the incidence of payment burdens before and after containment.

An additional complication for incidence analysis may also arise. There may be cases in which privatization or user fees would dissuade certain groups from consuming a service. Household budget and service consumption data would reveal neither payments nor benefits in the post-containment situation. In that case, the analysis of changes in the distribution of household well-being must take account of the net loss in well-being that results from reduced consumption.

One solution might be to calculate the characteristics of the "typical" household in a state by taking averages of such continuous variables as number of members, income, population of home jurisdiction, and modal value of discrete variables such as composition, tenure, race, etc. One could attempt to characterize a household by all those variables that influence either its tax obligations (e.g., tenure, income) or its service demands (e.g., composition). Once the typical household was designed, it would be possible, using survey results and forecasting techniques based on simulation methods, to calculate overall tax costs of the pre-containment bundle of services for this household. In addition one could estimate the changes in service receipts. Some service benefits can be evaluated in monetary terms, such as adult education courses and museum admissions, and thus made compatible. For other types of services--e.g., street repairs, park usage--no monetary value may be determinable.

It would be important in such an analysis to select a sample of jurisdictions that displayed variation in the range of service provided, taking into account both governmental and voluntary agency provision. The inclusion of these variables would illuminate the underlying structure of the service process and might further understanding of the possibilities for various kinds of privatization.

The second step in such analysis would be to calculate the resultant tax change, whether gain or loss, and the change in service receipt of the "typical" household. We could then answer questions such as: How would net household well-being shift as a consequence of:

- An increase or decrease in household income of $10,000?
- The addition of a school-age child?
- The addition of an elderly member?
- The addition of a handicapped person?
- A change in residential tenure?
- A major change in the degree to which the home jurisdiction is dependent on property tax?

The effect of each such characteristic on well-being would be calculated for the fiscal environment before and after the change.

With estimates of such "elasticities"--changes in household well-being as a function of household characteristics--it would be possible to judge the relative equity impacts of a fiscal containment measure.

LONGER-TERM IMPLICATIONS OF REDUCED OPPORTUNITIES FOR MINORITIES IN PUBLIC EMPLOYMENT

As fiscal containment unfolds at the local level, job prospects for minority workers, as we speculate above, will worsen. Not only will fewer be hired, but those already on public payrolls will also find that advancement comes slower. We discussed above the likely short-term effects on minorities of the contraction of the public work force; here we consider longer-term consequences. The portents for social mobility are bleak because, for black families particularly, government jobs have increasingly provided a stepping-stone into the middle class.

The black experience is not unique; many other ethnic groups before them have followed special paths leading upward. Italian restaurateurs, Chinese laundrymen, and Jewish merchants are outworn stereotypes, but nevertheless reveal important truths about how social mobility works in this country. The Irish constitute the classic case in the use of the public sector as a vehicle for mobility. Before the close of the 19th century, Irish Americans dominated municipal employment in many of the larger American cities. Although their jobs may initially have required little in the way of skills and education, they provided steady and respectable work.[5] Such positions were often the first rung of the ladder leading to higher pay and greater prestige. Perhaps more important were the intergenerational effects. Many of the sons (and later the daughters) of Irish policemen and municipal clerks found their way into business and the professions.

There is evidence that blacks have begun to follow a similar course. They have been helped by the fact that the public sector now comprises a much larger fraction of the labor market than it did in the 19th century. It has been estimated that in 1900 only 6 percent of the urban Irish labor force worked for the government, while in 1970 about 21 percent of employed blacks had public sector jobs.[6]

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[5] See Dahl, 1961, pp. 36-42. But for a less sanguine view of the Irish experience, see Thernstrom, 1973, pp. 132ff.

[6] Erie, 1979, pp. 7, 15. Erie relies on data from the U.S. Census.

One would need to analyze a vast number of individual careers and family histories, of course, to document how public jobs have improved minority status and what their effects have been on intergenerational social mobility. But casual observation makes a compelling case. It is certain that the Community Action Programs of the 1960s significantly expanded (and may even have created) a black middle class in not a few American cities. The offspring of black social workers and school-teachers stand a much improved chance of securing attractive positions and of progressing in rewarding careers. The same may soon become true for Hispanics.

In the pursuit of hard-headed analysis, we often forget that the local public sector supplies more than services in exchange for tax dollars. Historically, it has afforded employment to groups struggling upward. Jobs, too, are an output of local government. As voters seek to cut the fat in government, and even the scale of government, they should pause to consider the costs in opportunities forgone. A leaner and smaller public sector may also turn out to be meaner and harsher.

Chapter 6
CONCLUSIONS

The tax revolt is real. California is but one of 23 states that have limited taxes or government spending in the 1970s. Tax limitation movements have sprung up in response to a half-century's growth in government that has increased public spending from a tenth to a third of GNP and has, until very recently, made state and local governments the fastest growing employers in the economy. To cap it off, the economy is now suffering from frequent double-digit inflation and slowed growth in real incomes. Angry voters cannot directly reduce the price of gasoline, but they can cut the price of government.

There are myriad indications of citizen distrust of government, and much of the public criticism of taxing and spending is based in reality. Although property taxes are a diminishing fraction of local revenues, they remain objects of resentment. Even without rate increases, efficient reassessments have escalated property tax payments in areas undergoing inflation of real estate values: the case in California before Proposition 13.

The widespread public perception of wasteful government, which fritters away ever-increasing taxes on esoteric programs, may have some grounding in fact. Our case study of Los Angeles suggests that while revenues increased by 72 percent over the five years before Prop. 13, aggregate employment in the "basic" police, fire, and sanitation agencies barely changed. Simultaneously, the number of employees performing overhead, planning, and other nonbasic functions increased. Moreover, the administrative and support staff grew relative to direct service providers. Although administrative, planning, and support activities may increase the efficiency and effectiveness of direct service providers, the improvement is likely to be invisible to taxpayers, who are much more aware of patrol cars, fire engines, and trash trucks. Taxpayers may view administrative, planning, and support activities as "fat" that can be eliminated with no real loss of service.

Subnational governments have also spent increasing amounts on nontraditional, redistributive, and special-interest programs. Many

taxpayers, taking welfare as a model, seem to feel that such programs are riddled with fraud and accord them low priority compared with schools, police, fire protection, sanitation, and highways--traditional functions of state and local government that serve the entire citizenry. The middle class is taxed to support redistributive and special-interest programs, but may not directly benefit from them.

We must put "Proposition 13 fever" into perspective, however. Four points are relevant.

First, the current American tax revolt is merely the latest in a historical series. Many of the earlier rebellions resulted in changes in government finance that still persist. They often succeeded by replacing an unpopular tax with a new or less-resented one. (In the 1930s, for example, the imposition of state sales taxes--still an important source of state and, indirectly, local revenue--was often accompanied by strict limits on the rates at which local governments could tax property.) However, fiscal limits have often been successfully evaded, even in a conservative state like Arizona.

Second, Prop. 13 represents only one form of fiscal limitation. Others are not directed to a single tax, but control all government spending. Many of these measures impose long-range growth limits that tend to make local government planning far less difficult than under Proposition 13's severe cutback and year-at-a-time emergency funding from the state.

Third, we have marshalled some evidence (in California and elsewhere) that current fiscal limitation measures, although generally slowing the rate of government growth, have not had as great an effect as their supporters had hoped for.

Fourth, and perhaps most important, fiscal limitation statutes and constitutional amendments are but one of many causes of the restrained growth of state and local government that has occurred over the last five years. The erosion of many big-city tax bases, the election of more frugal officials (a grass-roots and unspectacular kind of tax revolt), and the shrinking real value of federal transfers, all encourage fiscal containment and betoken new circumstances affecting taxing and spending.

Although fiscal containment appeals to conservatives, one of its side-effects may displease them. As local sources of revenue dwindle, pressure will mount for larger grants from higher-level government, notably the state. Affected client and employee groups will apply a great deal of that pressure. State government may indeed be increasing its importance in the aid system relative to the federal and local levels, where the disadvantaged have historically found their most vocal advocates. Thus far, however, state governments have been loath to assume financial responsibility for local programs, but political and bureaucratic imperatives may push them into doing so; and in the long term control tends to follow hard on the heels of finance. As higher-level governments bail out needy localities, home rule--the responsiveness to local concerns--may be the ultimate victim.[1]

If, as we suspect, the growth of state and local governments will continue to slow, then research must analyze not only the causes of fiscal containment, but also its consequences. The precise form of fiscal limitation--or of other sources of containment--clearly influences governmental response. As an example, California's poorest cities, being least dependent on the property tax and most dependent on intergovernmental grants, were generally the least hurt by Prop. 13. A growth-limit approach to fiscal containment will generally permit more time and more latitude for governmental adaptation.

We hypothesize that short-run adjustments to cutbacks will be influenced by a variety of constraints: the political difficulties inherent in laying off employees or reducing nominal wages or fringe benefits, collective bargaining agreements, and legally mandated service levels either in state constitutions or as a condition for receiving intergovernmental grants. Over time, new sources of revenue may be found (e.g., user fees), payrolls may be adjusted through attrition or

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[1]For a general statement on this subject, see Hagman, 1978, who discusses how Prop. 13 may violate conservative principles. The rent control ordinances enacted in many California cities after Prop. 13's passage may be another violation of conservative ideology. We disagree with this interpretation, however. More likely, tenants were angry that Prop. 13 did not reduce rents, and wanted protection against further increases.

through wage freezes that reduce real compensation, service levels may be altered, and flexibilities in subvention standards may be found and exploited. Throughout, of course, perceptions of voter preferences will influence the behavior of officials, as will political action by interest groups, notably service clients and public employees. Research on interim and ultimate responses to various forms of fiscal containment in different sorts of communities will clarify the nature of the processes. At the same time, such research may suggest efficient ways for governments to adjust to fiscal containment.

Throughout, this report has emphasized the equity aspects of fiscal containment. At various points it suggests appropriate research topics. To the extent that fiscal limitation arises out of a middle-class tax revolt, the middle class may benefit from tax cuts, and the poor, minorities, and other disadvantaged groups may suffer from service cuts. Alternatively, the middle class may find itself paying fees for formerly "free" services. If seniority determines retention in public employment, minority workers who have recently been hired in disproportionate numbers may bear the brunt of terminations. Stasis or stagnation in government employment could impede long-term minority economic advancement. Again, research is needed.

State and local fiscal restraint (through formal limits or other means) may bring forth a period of prudent retrenchment to follow an era of rapid advances in subnational fiscal activity. Careful evaluation and stock-taking can reveal whether the plethora of new programs and novel departures have attained the objectives posited for them. In the 1960s innovative activities were established hastily; euphoria often took the place of sound analysis and evaluation. Fiscal containment may well provide the opportunity to improve program efficiency although it raises obvious problems for program finance. The coming years will present challenges to government officials. Life in an age of restraint will require tough decisions on which services merit protection and which can sustain reductions. Choices must be sensitive to both efficiency and equity considerations.

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